BILLING CODE: 8070-01-P

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1263

RIN 2590-AA39

Members of Federal Home Loan Banks

AGENCY: Federal Housing Finance Agency

ACTION: Notice of Proposed Rulemaking; request for comments.

SUMMARY: The Federal Housing Finance Agency (FHFA) is proposing to revise its regulations governing Federal Home Loan Bank (Bank) membership primarily to: (1) require each applicant and member institution to hold one percent of its assets in "home mortgage loans" in order to satisfy the statutory requirement that an institution make long-term home mortgage loans; (2) require each member to comply on an ongoing basis, rather than on a one-time basis as at present, with the foregoing requirement and, where applicable, with the requirement that it have at least 10 percent of its assets in "residential mortgage loans"; (3) define the term "insurance company" to exclude from Bank membership captive insurers, but permit existing captive members to remain members for five years with certain restrictions on their ability to obtain advances; (4) require a Bank to obtain and review an insurance company's audited financial statements when considering it for membership; and (5) clarify the standards by which an insurance company's "principal place of business" is to be identified in determining the appropriate Bank district for membership.

DATES: Written comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit your comments, identified by Regulatory Information Number (RIN) 2590–AA39, by any of the following methods:

• Agency Web site: www.fhfa.gov/open-for-comment-or-input.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by email to FHFA at RegComments@fhfa.gov to ensure timely receipt by the agency. Please include Comments/RIN 2590–AA39 in the subject line of the message.

• Courier/Hand Delivery: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA39, Federal Housing Finance Agency, 400 Seventh Street SW., Eighth Floor, Washington, DC 20024. Deliver the package to the Seventh Street entrance Guard Desk, First Floor, on business days between 9 a.m. to 5 p.m.

• U.S. Mail, United Parcel Service, Federal Express or Other Mail Service: The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA39, Federal Housing Finance Agency, 400 Seventh Street SW., Eighth Floor, Washington, DC 20024.

FOR FURTHER INFORMATION CONTACT: Eric M. Raudenbush, Assistant General Counsel, Office of General Counsel, Eric.Raudenbush@fhfa.gov, (202) 649-3084; or Julie Paller, Senior Financial Analyst, Office of Program Support, Division of Bank Regulation, Julie.Paller@fhfa.gov, (202) 649-3201 (not toll-free numbers), Federal Housing Finance Agency, 400 Seventh Street, SW., Washington, DC 20024. The telephone number for the Telecommunications Device for the Hearing Impaired is (800)

877-8339.

SUPPLEMENTARY INFORMATION:

I. Comments

FHFA invites comments on all aspects of the proposed rule and will take all comments into consideration before issuing a final rule. All comments received will be posted without change on the FHFA web site at http://www.fhfa.gov, and will include any personal information provided, such as name, address (mailing and email), and telephone numbers. In addition, copies of all comments received will be available without change for public inspection on business days between the hours of l0:00 a.m. and 3:00 p.m., at the Federal Housing Finance Agency, 400 Seventh Street, SW., Washington, DC 20024. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 649-3804.

II. Background

A. Overview of Bank Membership Requirements

1. Statutory Requirements

The twelve Federal Home Loan Banks were organized under the Federal Home Loan Bank Act (Bank Act) in 1932 to provide a reserve banking system for thrift institutions to support their residential mortgage lending activities.[1] Each Bank is structured as a cooperative, membership in which allows eligible financial institutions to obtain access to secured loans, known as advances, for the purpose of funding residential housing finance and, in some cases, for funding small business and community

[1] See 12 U.S.C. 1423, 1432(a). The Bank Act also allowed insurance companies to become members because they also supported the residential mortgage lending market.

development activities.[2] Bank membership is limited to the types of financial institutions listed in section 4(a)(1) of the Bank Act, which are: building and loan associations, savings and loan associations, cooperative banks, homestead associations, insurance companies, savings banks, community development financial institutions (CDFIs), and insured depository institutions.[3] Because nearly all state-chartered depository institutions are now federally insured, there are essentially three categories of institutions that are eligible for Bank membership: (1) FDIC- or NCUA-insured depository institutions; (2) insurance companies; and (3) CDFIs.

In order for any such institution to become a member of a Bank, it must comply with the three requirements set forth in section 4(a)(1) of the Bank Act, which require that the institution: (A) be duly organized under the laws of any state or the United States; (B) be subject to inspection and regulation under banking, or similar, laws of a state or the United States;[4] and (C) "makes such home mortgage loans as, in the judgment of the Director [of FHFA], are long-term loans."[5] An applicant that fails to satisfy any one of those requirements may not become a member of a Bank. (Hereinafter, those requirements will be referred to as the "duly organized," "subject to inspection and regulation," and "makes long-term home mortgage loans" eligibility requirements).

Section 4(a)(2) of the Bank Act imposes four additional eligibility requirements on insured depository institutions that were not members of a Bank as of January 1, 1989,

---

[2] See 12 U.S.C. 1430(a)(2).

[3] The Bank Act defines "insured depository institution" to include any bank or savings association the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC), as well as any credit union the member accounts of which are insured by the National Credit Union Administration (NCUA). 12 U.S.C. 1422(9).

[4] In lieu of being subject to inspection and regulation by a state or federal regulator, a CDFI applicant must be certified as a CDFI by the United States Department of the Treasury.

[5] 12 U.S.C. 1424(a)(1).

requiring that any such institution: (A) have at least 10 percent of its total assets in "residential mortgage loans"; (B) be in a financial condition such that advances may be safely made to it; and (C) show that the character of its management and its home-financing policy are consistent with sound and economical home financing.[6] (Hereinafter, those requirements will be referred to as the "10 percent," "financial condition," "character of management," and "home financing policy" eligibility requirements). The statute exempts from the "10 percent" requirement any "community financial institution" (CFI),[7] which are FDIC-insured depository institutions with less than $1 billion in average total assets (adjusted annually for inflation) over the preceding three years.[8]

2. FHFA's Existing Bank Membership Regulation

FHFA's regulation on Bank membership, located at 12 CFR part 1263, specifies how and when an institution must demonstrate compliance with each of the statutory membership eligibility requirements, and otherwise implements those requirements. The regulation also establishes requirements relating to the membership application process, determination of the appropriate Bank district for membership, members' purchase and redemption of Bank capital stock, and voluntary or involuntary termination and reacquisition of membership.

The regulation requires all insured depository institutions, insurance companies, and CDFIs to meet six eligibility requirements: the "duly organized," "subject to

---

[6] 12 U.S.C. 1424(a)(2). Although the statute groups these requirements into three paragraphs, FHFA and its predecessors historically have treated paragraph (a)(2)(C) as containing two separate eligibility requirements—that is, the "character of management" and "home financing policy" requirements.
[7] See 12 U.S.C. 1424(a)(2)(A), (a)(4).
[8] 12 U.S.C. 1422(10)(A). By statute, FHFA must annually adjust the $1 billion CFI asset limit for inflation. 12 U.S.C. 1422(10)(B). The inflation-adjusted CFI limit for 2014 is $1.108 billion. See 79 FR 1862 (Jan. 10, 2014).

inspection and regulation,"[9] and "makes long-term home mortgage loans" requirements, which by statute apply to all types of institutions; and the "financial condition," "character of management," and "home financing policy" requirements, which FHFA and its predecessor agency, the Federal Housing Finance Board (Finance Board) have applied by regulation to all institutions as a matter of safety and soundness. Paralleling the statute, the membership regulation requires that non-CFI depository institutions also meet the "10 percent" requirement in order to be eligible for membership, but does not extend that requirement to other types of institutions. However, the regulation does require institutions that are not insured depository institutions (i.e., insurance companies and CDFIs) to have "mortgage-related assets" that "reflect a commitment to housing finance" in order to be eligible for membership.[10] For each of the six general eligibility requirements and for the "10 percent" requirement, the regulation includes at least one separate section specifying how a Bank is to determine whether an institution satisfies the requirement.

The membership regulation also supplements the Bank Act by defining the terms "long-term," "home mortgage loan," and "residential mortgage loan." The Bank Act defines the term "home mortgage loan" to mean "a loan made by a member upon the security of a home mortgage."[11] In turn, the statute defines the term "home mortgage" to mean a first mortgage, or its equivalent, upon real estate on which one or more homes or

---

[9] An institution certified as a CDFI by the Treasury Department's CDFI Fund is deemed to have met the "subject to inspection and regulation" requirement by virtue of that certification. See 12 CFR 1263.6(a)(2), 1263.8.

[10] 12 CFR 1263.6. The regulation does not define the term "mortgage-related assets."

[11] 12 U.S.C. 1422(4).

dwelling units are located.[12]

The regulation supplements the statutory definition of "home mortgage loan" by defining the term generally to include any loan or interest in a loan that is secured by a first lien mortgage or any mortgage pass-through security that represents an undivided ownership interest in such loans or in another security that represents an undivided ownership interest in such loans.[13] The regulation defines the term "long-term," which the statute does not define, to mean "a term to maturity of five years or greater."[14]

The regulation defines the term "residential mortgage loan," which relates to the Bank Act's "10 percent" requirement, and which the statute does not define, more broadly than the term "home mortgage loan." It defines "residential mortgage loan" to include generally all assets that qualify as home mortgage loans (regardless of whether the underlying loans are "long-term" or not), plus loans secured by junior liens on one-to-four family property or multifamily property, loans secured by manufactured housing, funded residential construction loans, and mortgage pass-through securities representing an ownership interest in, or mortgage debt securities secured by, any of those types of assets.[15]

Unlike the "10 percent" requirement, the Bank Act does not establish quantifiable standards for determining compliance with the "makes long-term home mortgage loans" requirement. Neither does the existing membership regulation establish any quantifiable standards. The regulation implements the "makes long-term home mortgage loans" requirement through a "presumptive compliance" approach, which deems an institution

---

[12] 12 U.S.C. 1422(5).
[13] 12 CFR 1263.1.
[14] 12 CFR 1263.1.
[15] 12 CFR 1263.1.

to have satisfied the statutory requirement if, at the time of its application for Bank membership, its most recently filed regulatory financial report demonstrates that it originates or purchases long-term home mortgage loans.[16] However, the regulation does not specify the level of activity that is needed to meet the requirement.

In addition, the existing membership regulation does not require a Bank to assess compliance with the "makes long-term home mortgage loans" requirement for any institution once it has become a member of the Bank. In other words, the regulation does not require that a Bank member continue to originate, purchase, or hold long-term home mortgage loans after it has become a member. The absence of an ongoing requirement means that it is possible that an institution could reduce or eliminate its investment in long-term home mortgage loans after becoming a member without affecting its eligibility to continue as a Bank member.

The existing regulation also employs a "presumptive compliance" approach to the "10 percent" requirement, deeming an applicant subject to that statutory requirement to be in compliance if its most recent regulatory financial report shows that it has at least 10 percent of its total assets in residential mortgage loans.[17] As with the "makes long-term home mortgage loans" requirement, the regulation does not require an institution that is subject to the "10 percent" requirement to continue to hold 10 percent of its total assets in residential mortgage loans after it becomes a Bank member. The absence of an ongoing requirement means that a member may reduce, or even eliminate, its residential mortgage loan holdings without affecting its eligibility to continue as a Bank member.

---

[16] 12 CFR 1263.9.
[17] 12 CFR 1263.10.

B. Advance Notice of Proposed Rulemaking

In creating the Banks, Congress vested in them a number of market advantages designed to enable them to raise funds in the capital markets at interest rates slightly higher than those on comparable Treasury instruments. Those advantages were designed to enable the Banks to provide low cost wholesale funding to their member institutions so that, in turn, those members could provide long-term home mortgage loans to consumers at a reasonable cost. The text of the Bank Act and its legislative history indicate that Congress intended to reserve the benefits of Bank membership, including access to low cost funding and the receipt of dividends on Bank stock, for institutions that are likely to use those benefits to fulfill the primary purposes of the Bank Act. In 2010, FHFA began a review of its membership regulation to determine whether it effectively implements the statutory requirements and advances the purposes that underlie those requirements. One aspect of that review has been to assess whether the existing regulatory membership eligibility requirements, as they are currently applied, could permit the Banks to admit as a member an institution that has such a tenuous connection to home mortgage lending that it should not be allowed to access the benefits of Bank membership.

On December 27, 2010, FHFA published in the Federal Register an Advance Notice of Proposed Rulemaking (ANPR), in which the agency discussed, and requested comment on, a number of ways it could revise its membership regulation to ensure that the benefits of Bank membership are being used to further the statutory mission of the Federal Home Loan Bank System (Bank System).[18] Among other things, the ANPR reviewed both the "makes long-term home mortgage loans" and "10 percent"

---

[18] See 75 FR 81145 (Dec. 27, 2010).

requirements and discussed whether the regulatory provisions implementing those requirements could be revised to strengthen the ties between Bank membership and the support of housing finance by Bank members. The ANPR examined whether it would be appropriate to amend either or both of those requirements to apply on a continuing basis, rather than only at the time of admission to membership. In addition, the ANPR discussed whether it would be appropriate to establish more objective and quantifiable standards for the "makes long-term home mortgage loans" requirement. With respect to each of those issues, FHFA requested comments on how well the existing regulations implement the underlying statutory requirements, whether there is a need to revise the regulations to reinforce the connection between membership and the Banks' housing finance mission, and the appropriateness of the alternatives being considered by the FHFA. Separately, the ANPR also discussed both safety and soundness- and mission-related concerns about the acceptance of so-called "captive" insurers as Bank members and queried whether, to address these concerns, FHFA should amend the membership regulation to require that insurance companies be actively engaged in underwriting insurance for third parties and be actively examined and supervised by their appropriate state insurance regulator in order to be eligible for membership.

FHFA received 137 comment letters in response to the ANPR, almost all of which opposed revising the membership regulation in any of the ways discussed in the notice, and very few of which actually responded to the specific questions raised in the ANPR. With respect to the "makes long-term home mortgage loans" and "10 percent" requirements, the comments appearing most frequently in the letters were that: the ANPR did not explain the purposes to be served by revising the requirements; requiring ongoing compliance would make membership less attractive by reducing access to liquidity, adding costs and paperwork requirements, and creating uncertainty about an institution's ability to remain eligible for membership from period to period; such regulatory changes would constrict the availability of funds for housing finance and community development; and the housing finance nexus that ongoing eligibility requirements would be intended to preserve is already provided by the existing collateral requirements, which require advances to be secured by assets that may include mortgage loans on improved residential property.

A comparatively small number of the comment letters provided substantive responses to some or all of the ANPR questions. With respect to whether FHFA should make the "10 percent" requirement ongoing and the manner in which such a requirement might be implemented, a number of credit unions provided substantive comments. These included suggestions that: FHFA give Banks flexibility in applying the requirement, such as by adjusting the percentage downward during any housing finance downturns; FHFA base the measurement of compliance with an ongoing requirement either on an average over a specific time period (which would help to avoid skewed data resulting from seasonal changes in lending and similar factors), or on the highest amount of qualifying assets held at any point in time during a specified time period; and FHFA require members to report noncompliance to their Banks only if they have been out of compliance with the requirement for at least 90 days.

FHFA received minimal response to its request for comment on whether it should require members to comply with the "makes long-term home mortgage loans" requirement on an ongoing basis. However, some credit union and insurance company commenters did not object to an ongoing “makes long-term home mortgage loans” requirement, so long as it did not also impose quantitative standards.

In response to FHFA’s query as to whether it should impose one or more quantitative standards for determining compliance with the “makes long-term home mortgage loans” requirement, two CDFIs supported establishing a quantitative standard, so long as FHFA develops appropriate standards for each class of institution that may become a member (although neither opined as to what those standards should be). Another CDFI opposed quantifiable standards, stating that such a requirement would effectively reduce the ability of CDFIs to provide other forms of credit and investments that they typically provide to low- and moderate- income communities. One credit union that supported an ongoing requirement stated that compliance should not be based on a specific percentage or quantity of mortgage loans (especially if based on loan originations), as that would be unfair to smaller lenders and to institutions operating in lower-cost real estate markets that have relatively low average loan sizes. No commenters identified particular levels of home mortgage loans that could be deemed to satisfy this requirement.

FHFA received several comments that were responsive to its query as to how a member’s noncompliance with any new ongoing membership requirements should be addressed, and whether termination of membership or some lesser sanctions would be most appropriate for addressing such noncompliance. In their joint comment letter, the Banks contended that noncompliance should not lead to automatic termination of membership, nor should it require the Bank to terminate an institution’s membership. The Banks urged FHFA to provide them with the flexibility to cure instances of temporary noncompliance with any new and ongoing membership requirements. One CDFI recommended a one year grace period for members that fall out of compliance and also advocated a reasonable transition period for members that are not in compliance at the time the rule is finalized. Another CDFI was more supportive of a strict compliance regime, stating that, if a member is found to be out of compliance, its membership should be terminated after an appropriate grace period, during which the member should be barred from further access to new Bank services. Several credit unions stated that members (specifically, credit unions) should be permitted a period of perhaps one year to cure any non-compliance, based on a good faith representation that the member will attempt to comply.

FHFA also received several comment letters addressing the agency's stated concerns about captive insurers and responding to the related query regarding the possibility of permitting only insurance companies that are actively engaged in underwriting insurance for nonaffiliated parties and that are actively examined and supervised by their state insurance regulator to be Bank members. Those commenters, which included three state insurance regulators, all opposed amending the regulation in the manner suggested, arguing that captive insurers are generally subject to the same state laws, regulations, and oversight as are other insurance companies. None of the commenters addressed FHFA's mission-related concern that captive members may be acting as conduits to provide advances to affiliated companies that are themselves ineligible for Bank membership.

C. Development of the Proposed Rule

1. Summary of proposed rule's principal provisions

After considering the comments received in response to the ANPR and further studying the issues addressed in that notice, FHFA has decided to publish this proposed rule, which would revise the membership regulation to implement more effectively the statutory eligibility requirements. The proposed rule would establish a quantitative standard for determining compliance with the "makes long-term home mortgage loans" requirement, specifying that an institution must have at least one percent of its total assets in home mortgage loans in order to meet that requirement. The proposed rule also would require each Bank member to maintain the one percent ratio on an ongoing basis in order to remain eligible for Bank membership. Similarly, the rule would require each Bank member that is subject to the "10 percent" requirement to maintain 10 percent of its assets in residential mortgage loans on an ongoing basis in order to remain eligible for Bank membership. It would require each Bank to determine member compliance with those ongoing requirements annually, using data from members' regulatory financial reports where possible, and auditor certifications where necessary, to calculate the relevant ratios based on a three-year rolling average. Members found to be out of compliance with either requirement would be given one year to return to compliance. A Bank would be required to terminate the membership of any institution that remains out of compliance for two consecutive years.

In conjunction with its proposal to require an applicant or member to maintain a specified percentage of its total assets in home mortgage loans, FHFA is also proposing to expand the list of assets that qualify as "home mortgage loans" to include all types of mortgage-backed securities (MBS) that are fully backed by first mortgage loans on single- or multi-family property or by other securities that are fully backed by such loans.

Under the existing regulation, only pass-through securities representing an undivided ownership in qualifying loans or securities may be counted as "home mortgage loans." The rule would not substantively change the definition of the term "residential mortgage loan" or subject any institution to the "10 percent" requirement that is not currently subject to that requirement.

The proposed rule would also make a number of other revisions relating specifically to insurance companies. First, it would limit the types of insurance companies that are eligible for membership by defining the term "insurance company" to include only those companies whose primary business is the underwriting of insurance for nonaffiliated persons or entities. Second, it would require that, in determining whether an insurance company applicant meets the "financial condition" requirement, a Bank examine the applicant's most recent audited financial statements, in addition to its most recent regulatory report, which is the sole required source of information under the existing regulation. Finally, the rule would add a new provision addressing how the Banks should determine the "principal place of business" for insurance companies (as well as for CDFIs).

In addition to these primary revisions, the proposed rule would make a number of conforming changes necessary to integrate the new requirements into the regulation and make some non-substantive revisions to better state various provisions of the regulations.

2. <u>Policy and legal considerations behind proposed substantive revisions</u>

a. <u>Changes to the "makes long-term home mortgage loans" and "10 percent" requirements</u>

As the agency charged by Congress with administering the Bank Act, FHFA has broad authority to interpret the statute regarding issues on which it is silent or ambiguous. The Bank Act does not address whether an institution must engage in any particular minimum level of home mortgage lending in order to be considered to "make[] such home mortgage loans . . . as are long-term loans" as required under section 4(a). The statute also does not address whether a Bank member that ceases to comply with any of the eligibility requirements of section 4(a) may or must be permitted to continue as a member of a Bank. Accordingly, FHFA has the authority to resolve those questions in a way that renders the eligibility requirements meaningful and effective and that advances the overall purposes of the Bank Act. Specifically, FHFA may adopt a quantitative standard for determining whether an institution complies with the "makes long-term home mortgage loans" requirement and may require that Bank members continue to comply with both the "makes long-term home mortgage loans" and "10 percent" requirements as a condition of retaining their Bank membership.

Section 4(a) of the Bank Act specifies that an institution may be eligible for Bank membership only if it "makes such home mortgage loans as, in the judgment of the Director, are long-term loans." The Bank Act, however, does not address the amount of home mortgage loans an institution must originate or purchase, or the period of time over which an institution must have been engaged in that activity, in order to demonstrate that it makes long-term home mortgage loans. Likewise, the legislative history of the Bank Act sheds little light on how Congress intended the "makes long-term home mortgage loans" requirement to be applied. Much of the discussion of the issue in the legislative record centers around the requirement that the mortgage loans made must be "long-term" and the relationship of that requirement to the Bank Act's primary purpose of providing funds to lending institutions to make long-term fully amortizing home mortgage loans. The lack of discussion in the legislative history about how the "makes long-term home mortgage loans" requirement is to be applied is not surprising, given that all of the depository institutions that were eligible for Bank membership in 1932 were state-chartered home mortgage lenders that had little, if any, ability to engage in any other types of lending.

The statute and its legislative history are also silent on whether an institution must comply with the membership eligibility requirements of section 4 only when it first becomes a Bank member or also must continue to comply with them in order to remain a member. Both sections 4(a) and 4(b) of the Bank Act refer to their respective eligibility provisions as requirements that must be met in order to "become" a Bank member. That Congress used the word "become," however, does not mean that it intended that the statutory eligibility requirements would apply only when an institution first sought to be admitted to membership, but not thereafter. It appears clear that Congress intended to prohibit any applicant that could not demonstrate compliance with the eligibility requirements of section 4 from being admitted to membership. Given the apparent congressional intent to condition admission to membership on an institution's demonstrated support of residential mortgage lending, as shown by compliance with the eligibility requirements, it would be illogical to conclude that Congress would have also intended to allow institutions to abandon their commitment to the residential mortgage markets after having been admitted to membership in a cooperative, the purpose of which was to promote residential mortgage lending. The legislative histories of the original Bank Act and its many amendments support that view, in that they make clear that

Congress contemplated that Bank membership would comprise institutions that meet the eligibility requirements specified in section 4 of the Bank Act.

One indication of congressional intent can be found in section 4(a)(3) of the Bank Act, which permits a newly chartered insured depository institution to become a Bank member without meeting the "10 percent" requirement, so long as it subsequently demonstrates that it has satisfied that requirement within one year after commencing its business operations.[19] For such institutions, compliance with this eligibility requirement occurs after the institution "becomes" a member, which is consistent with construing the eligibility requirements to apply on an ongoing basis. FHFA believes that to construe section 4 of the Bank Act as precluding it from applying the "makes long-term home mortgage loans" and "10 percent" requirements on an ongoing basis would not be reasonable and would effectively undermine the intent of Congress that the benefits of Bank membership be used to advance the housing finance mission of the Bank System.

In cases where Congress has not addressed the precise question at issue, an agency has the authority to adopt a "permissible construction" of a statute it administers.[20] In Texas Savings and Community Bankers Ass'n v. Federal Housing Finance Board, the United States Court of Appeals for the Fifth Circuit concluded that the Finance Board's interpretation of the "incidental powers" clause of section 11(a) of the Bank Act as permitting a Bank to fund mortgage loans directly through its member institutions (a power that is not expressly granted by the statute) was permissible because

[19] 12 U.S.C. 1424(a)(3).

[20] See Chevron v. Natural Resources Defense Council, 467 U.S. 837, 843 (1984); see also Texas Savings and Community Bankers Ass'n v. Federal Housing Finance Board, 201 F.3d 551, 554 (5th Cir. 2000) (court's review of former Federal Housing Finance Board's construction of Bank Act was guided by Chevron principles).

it was "consistent with the structure and purpose" of the Bank Act.[21]

In the Housing and Economic Recovery Act of 2008,[22] Congress amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act) to establish FHFA as supervisor and regulator of the Banks, as well as Fannie Mae and Freddie Mac (each a "regulated entity"), and vested in its Director general regulatory authority over those regulated entities.[23] Congress also mandated that the Director exercise that regulatory authority so as to ensure that the purposes of the Safety and Soundness Act and the Bank Act are carried out.[24] Section 1313 of the Safety and Soundness Act further charges the Director with several specific duties, including the duties to ensure that: "the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets"; "each regulated entity complies with [the Safety and Soundness Act] and the rules, regulations, guidelines, and orders issued" under the Safety and Soundness Act and the Bank Act; and "the activities of each regulated entity and the manner in which such regulated entity is operated are consistent with the public interest."[25] Finally, section 1326 of the Safety and Soundness Act authorizes and requires the Director to "issue any regulations, guidelines, or orders necessary to carry out the duties of the Director under [the Safety and Soundness Act or the Bank Act], and to ensure that the purposes of [those statutes] are accomplished."[26]

---

[21] Texas Savings, 201 F.3d at 556; see also Independent Insurance Agents of America, Inc. v. Hawke, 211 F.3d 638, 643 (D.C. Cir 2000) (stating that "[c]ourts generally will defer to an agency's interpretation of its statute if it is 'reasonable and consistent with the statute's purpose.'").
[22] Pub. L. 110-289, Div. A, 122 Stat. 2654 (2008).
[23] 12 U.S.C. 4511(b).
[24] 12 U.S.C. 4511(b)(2).
[25] 12 U.S.C. 4513(a)(1).
[26] 12 U.S.C. 4526(a).

The primary purpose of the Bank Act, since its initial adoption in 1932, has been to support the nation's housing markets by establishing a system of Banks to provide wholesale funds to their member institutions for the purpose of financing those members' residential mortgage lending activities. The "makes long-term home mortgage loans" and "10 percent" requirements reflect that purpose, as do several other provisions of the statute. For example, the Bank Act states that a Bank may make long-term advances to members only for the purposes of providing funds for residential housing finance.[27] Similarly, the Bank Act limits the types of collateral that a Bank may accept from its members to five categories, among which are whole first mortgage loans on improved residential property and securities representing an interest in such mortgage loans, as well as residential MBS issued by Fannie Mae, Freddie Mac, and Ginnie Mae.[28] Other statutory provisions promote that purpose by requiring each Bank to establish and fund an Affordable Housing Program (AHP) to provide subsidies to members engaged in lending for long-term, low- and moderate-income, owner-occupied and affordable rental housing.[29] Congress's decision to include such "housing finance" requirements in the Bank Act, touching on several aspects of Bank-member interactions, reflects an intent that the benefits of Bank membership – such as the ability to obtain advances – accrue to institutions that are engaged in residential mortgage lending.

Because the current membership regulation does not require an applicant to have any specific amount of home mortgage loans, it is possible to satisfy the "makes long-

[27] See 12 U.S.C. 1430(a)(2). This provision also allows Banks to make long-term advances to its "community financial institution" members for the purpose of providing funding for their small business, small farm, small agri-business, and community development lending activities.
[28] See 12 U.S.C. 1430(a)(3)(A) – (B).
[29] See 12 U.S.C. 1430(j).

term home mortgage loans” requirement by acquiring a minimal amount of home mortgage loans shortly before applying for membership. Because the regulation does not require that an institution continue to meet either the “makes long-term home mortgage loans” requirement or the “10 percent” requirement on an ongoing basis once it becomes Bank member, it also is possible for an institution to reduce or eliminate its mortgage loan holdings after becoming a member without losing its eligibility to continue as a Bank member. Thus, it is currently possible for an institution to become a member without having either a history of supporting residential housing finance through the origination or purchase of home mortgage loans or a demonstrated intent to significantly support the residential housing finance market after becoming a member.

In recent years, there have been instances in which institutions having only minimal home mortgage loan assets and no plans to originate or purchase any significant amounts of such assets have been permitted to become Bank members. Although FHFA has found no evidence that this problem is widespread, it believes that, to the extent the current regulation allows for the possibility that institutions having no significant past or future involvement in home mortgage lending may become and remain Bank members, it does not advance the purposes of the Bank Act. Accordingly, the agency has determined that it is necessary to revise its Bank membership regulation to establish a minimum quantitative standard that must be met to satisfy the “makes long-term home mortgage loans” requirement, and to require ongoing compliance with both that requirement and the “10 percent” requirement. With those revisions, the membership regulation would better ensure that the benefits of membership, such as favorably priced funding through advances, accrue only to institutions that demonstrate a meaningful commitment to supporting residential housing finance and, therefore, would better ensure that the Banks fulfill their housing finance mission. Accordingly, FHFA believes that these new regulatory requirements implement the Bank Act in a way that is "consistent with the purposes and structure" of that Act and that is within the authority granted to the agency by both the Bank Act and the Safety and Soundness Act.

As reflected in the existing membership regulation, FHFA's predecessor agencies interpreted section 4 of the Bank Act as allowing compliance with the "makes long-term home mortgage loans" and "10 percent" requirements to be measured only at the time an institution applies for Bank membership. Those predecessor agencies also concluded that section 4(a) does not require an institution to originate or purchase any minimum level of long-term home mortgage loans in order to be eligible for Bank membership. Those prior interpretations, however, do not preclude FHFA from now adopting a different—but permissible—policy that it believes better serves the purposes of the Bank Act, so long as that change in policy is explained and justified.

Although none of FHFA's predecessor agencies adopted a regulation applying a quantitative standard to the "makes long-term home mortgage loans" requirement or applied that requirement on an ongoing basis, as a matter of practice the former Federal Home Loan Bank Board (FHLBB) required an institution to provide evidence that it had a continuing policy of mortgage loan purchases or originations and that it intended to continue to pursue that policy. In internal memoranda, FHLBB staff concluded that isolated or sporadic home mortgage loan originations or purchases were not sufficient to demonstrate compliance with the “makes long-term home mortgage loans” requirement.[30] Often, the application of that requirement was considered in conjunction with the “home financing policy” requirement, which for many years was considered to require that an institution demonstrate through its actions that it had an active and ongoing policy to finance home mortgage loans.

b. Addition of definition of “insurance company”

Although both section 4(a)(1) of the Bank Act and § 1263.6(a) of the existing regulation list an “insurance company” among the types of institutions that are eligible for Bank membership, neither provision defines that term. As was discussed in the preceding section, where the statute does not define a term FHFA has the authority to define it by regulation, as necessary to give effect to the purpose and intent of the statute. Thus, the proposed rule would define the term “insurance company” to mean “a company whose primary business is the underwriting of insurance for nonaffiliated persons or entities.” The principal effect of this provision would be to prohibit captive insurers from becoming Bank members.[31] In a related provision, the proposed rule would permit any captive that had been admitted to membership prior to the publication date of this proposed rule to remain a member of its current Bank for five years following the effective date of the final rule, but would cap the amount of advances that a Bank could have outstanding to such a member at 40 percent of the member’s total assets and prohibit a Bank from making a new advance, or renewing an existing advance, with a

[30] See, e.g., FHLBB Office of General Counsel Memorandum from Deputy General Counsel Julie L. Williams (Jan. 25, 1988) at 3 (citing earlier memoranda and opining that an institution may satisfy the “makes long-term home mortgage loans” requirement by purchasing home mortgage loans, so long as the purchases “evidence a continuing policy of purchase activity rather than being ‘mere isolated instances . . . .’”).

[31] Captive insurers are typically formed by a company as a means of self-insuring certain risks associated with the business of the parent company or an affiliate.

maturity date beyond the five year grace period to such a member. These provisions would not affect the eligibility of other traditional insurance companies to become members, to remain as members, or to obtain advances.

FHFA is taking these actions to address supervisory concerns about certain institutions that are ineligible for Bank membership, but that are using captives as vehicles through which they can obtain Bank advances to fund their business operations. These supervisory concerns are particularly acute when the amounts of advances sought in the name of the captive insurance subsidiary are larger by far than the amount of its insurance liabilities or are comparable to the total assets of the captive. Such circumstances confirm that the advances are not being used by the captive member, but for the business needs of its parent company or an affiliate, which may be barred by law from obtaining Bank advances in its own name. Defining the term in this manner also reflects the likely intent of Congress. When Congress authorized insurance companies to become Bank members in 1932, the concept of captive insurers was essentially unknown in the United States.[32] At that time, insurance companies, particularly life insurance companies, frequently made or purchased mortgage loans which, as longer-term investments, better matched the liabilities that the insurance companies had to their policyholders.

In recent years, a small but growing number of captives have become Bank members. FHFA has scrutinized those institutions and believes that in some cases the primary, or sole, motivation for those captives being created has been to become

[32] The first captive insurer in the U.S. is generally thought to have been a subsidiary of the Youngstown Sheet and Tube Company that was chartered in Ohio in the 1950s. See Peter J. Strauss, The Definitive Guide to Captive Insurance Companies 18-20 (2011).

members in order to serve as a funding conduit through which a parent or affiliate of the captive, which is not itself eligible for Bank membership, may gain access to Bank advances. Those captives have been able to become members because the existing regulation does not prohibit it and does not otherwise distinguish between insurance companies that become members to support their own operations and those that become members with the intention of obtaining advances to finance the business operations of a parent or affiliate.

Recently, several real estate investment trusts (REITs), which are not eligible to become members, have established captive subsidiaries that then became Bank members. A number of those captives then obtained advances in dollar amounts so large that they appear to have no relationship to the operations of the captive and appear to flow to the REITs. The facts that many of those REITs guarantee repayment of the advances made to their captive subsidiaries and provide the collateral for those advances further support the conclusion that the real business and economic purpose of these arrangements is to allow the non-member REITs to obtain Bank advances.[33] Although mortgage REITs are involved in the residential housing finance markets, they are not among the types of institutions that Congress has authorized to become Bank members or to borrow from the Banks, and through the use of captives they have been able to borrow indirectly from the Banks—something the statute precludes them from doing directly. The proposed rule is intended to prevent these arrangements, which FHFA views as circumventing the intent

[33] This also raises safety and soundness concerns because, in the case of REITs, the Banks do not currently have access to the kind of detailed financial and supervisory information that is readily available to them in the case of institutions that are eligible for Bank membership.

of Congress that the benefits of membership are to be available only to the types of eligible institutions enumerated in the Bank Act.

FHFA understands that it is possible for other types of institutions, including depository institutions owned by a bank holding company, to pass along the economic benefits of membership to their holding company parent or other affiliates, which may not themselves be eligible for membership. In those cases, however, it is unlikely that a federally insured depository institution would have been created for the sole or primary purpose of serving as a funding vehicle for its parent or affiliates. The requirements under state and federal law for organizing and capitalizing a commercial bank or savings association, as well as the requirements associated with obtaining federal deposit insurance, effectively ensure that such institutions will be principally engaged in the business of banking. It is also unlikely that a federally insured depository institution or a traditional insurance company could be established to function solely or primarily as a conduit funding vehicle for Bank advances, and it is even less likely that such an institution would be allowed, as certain captives have done, to obtain advances in amounts comparable to the amount of its total assets. For those reasons, FHFA believes that any future instances in which a depository institution or other insurance company may function to an inappropriate degree as a conduit for its parent or affiliates could be addressed through FHFA's oversight and examination functions.

In addition, captives present a number of safety and soundness concerns for the Banks beyond those presented by insured depository institutions and traditional insurance companies. Among these are the potential that the captive's financial condition could worsen without the Bank's knowledge due to the relative unavailability of objective financial information and ratings as compared to other insurers and depository institutions; the financial condition of the captive, which operates to serve the parent, rather than in its own financial self-interest, may deteriorate rapidly due to the actions of the parent; the parent might decline to provide financial support, or to provide additional collateral, in cases of financial distress; and that the captive's balance sheet may reflect non-diversified risk if its underwriting activities are narrowly prescribed by the parent.

c. Expansion of definition of "home mortgage loan"

FHFA is also proposing to expand the definition of "home mortgage loan" to include all types of MBS backed by qualifying whole loans and securities. Currently, the definition includes only whole loans secured by a first lien mortgage on residential property and mortgage pass-through securities representing an undivided ownership interest in such loans or in another security that represents an undivided ownership interest in such loans.[34] In effect, the current regulation distinguishes between MBS that provides the holder with a pro rata ownership interest in each of the loans in the underlying pool of mortgage loans, and MBS that gives the holder only a right to a specified portion of the cash flows generated by the underlying pool of mortgage loans. Early in the history of the Bank System, the FHLBB determined that an institution's purchase of mortgage loans was the equivalent of "making" such loans for purposes of complying with the "makes long-term home mortgage loans" requirement. In 1988, the FHLBB first permitted an applicant for Bank membership to use mortgage pass-through securities to meet the "makes long-term home mortgage loans" requirement, provided that those securities represented an undivided ownership interest in qualifying whole

[34] 12 CFR 1263.1.

loans and that the frequency of the institution's purchases evidenced an ongoing policy.[35] When the Finance Board adopted its 1993 membership regulation, it adopted the FHLBB's policy on the use of pass-through securities to satisfy the "makes long-term home mortgage loans" requirement, but declined to permit the use of collateralized mortgage obligations (CMOs), real estate mortgage investment conduits (REMICs), and other non-pass-through MBS for that purpose.[36] The Finance Board did not assert that the Bank Act prohibited it from including non-pass-through MBS backed by qualifying loans within the definition of "home mortgage loan" and, in fact, noted that it had counted CMOs in assessing applicants' compliance with the "makes long-term home mortgage loans" requirement prior to adopting its membership regulation in 1993.

Thus, the current distinction between MBS that give the holder an ownership interest in the underlying loans and those that give the holder a right to certain cash flows from the loans represents a policy determination by the Finance Board about the types of securities that could constitute "home mortgage loans." Accordingly, FHFA is not prohibited from expanding the definition of "home mortgage loan" to include MBS that are not pass-through securities, so long as that MBS is backed by whole loans that qualify as "home mortgage loans" or securities representing an interest in such loans. In the current financial markets, investors recognize that all types of MBS essentially represent a right to some portion of the cash flows from the underlying mortgage loans. Whether, for example, the holder of the security has an undivided ownership interest in the underlying pool of mortgage loans, or has a beneficial ownership interest in the trust

---

[35] See FHLBB Office of General Counsel Memorandum from Deputy General Counsel Julie L. Williams (Jan. 25, 1988).

[36] See 58 FR 43522, 43526 (Aug. 17, 1993).

holding the mortgages, or has a contractual right to a specified portion of the cash flows generated by the underlying mortgages will vary depending upon the type of payment, risk, and maturity characteristics the issuer is attempting to achieve. The economic interest of all such instruments is much the same, and the forms of the respective instruments are more of a legal technicality that is neither decisive as to the nature of the economic interest that the owner holds nor the level of support for the mortgage market that the securities provide. Indeed, the availability of the many types of MBS with different characteristics that have evolved to meet investors' needs over the past several decades has made the secondary mortgage market much more liquid. In recognition of this, FHFA believes that it is appropriate to expand the definition of "home mortgage loan" to include all types of MBS backed by qualifying assets and eliminate the current distinction that the rules draw between pass-through securities and other types of MBS.

III. The Proposed Rule

A. Definitions—§ 1263.1

The proposed rule would revise the definitions of several terms set forth in § 1263.1 and would also add several new definitions. The only substantive changes to the definitions under the proposed rule would be an expansion of the definition of "home mortgage loan" to include all types of MBS backed by qualifying loans and securities and the addition of definitions for the terms "insurance company" and "captive." As discussed above, proposed § 1263.1 would define "insurance company" to mean "a company whose primary business is the underwriting of insurance for nonaffiliated persons or entities." In connection with this, the rule would define "captive" to mean "a company that is authorized under state law to conduct an insurance business, but that does not meet the definition of 'insurance company' . . . or fall within any other category of institution eligible for membership."

Existing § 1263.1 defines "home mortgage loan" as: (1) a loan or interest in a loan that is secured by a first lien mortgage on one-to-four- or multi-family property; or (2) a mortgage pass-through security that represents an undivided ownership interest in such loans or in another security that represents an undivided ownership interest in such loans. The proposed rule would replace the specific reference to a pass-through security in paragraph (2) of the definition with a more general reference to a security representing either: (i) a right to receive a portion of the cash flows from a pool of qualifying loans; or (ii) an interest in other securities representing such a right. The reference to a right to receive a portion of the cash flows is intended to encompass the rights of a holder of a mortgage pass-through security to an undivided ownership interest in the underlying loans and their principal and interest payments, as well as the rights of a holder "debt-type" instruments that grant the holder the right to a specified portion of the cash flows from the pooled mortgage loans. Thus, the proposed revision is intended to bring within the definition of "home mortgage loan" all types of MBS—including pass-throughs, CMOs, REMICs, and principal-only and interest-only strips—that are fully backed by whole loans that meet the definition of "home mortgage loan" or by other MBS that are fully backed by such loans. The revised definition is not intended to include a bond or other debt security that is a general obligation of the issuer, even if it is collateralized by qualifying mortgage loans.

Each of the remaining revisions to § 1263.1 is intended only to shorten or otherwise clarify either the definition itself or the regulatory text in which the defined term appears; none of the remaining revisions is intended to alter the meaning of any defined term or substantive provision. The proposed rule would revise the definitions of the terms "appropriate regulator" and "CRA" in § 1263.1 to substitute, for terms that are defined in 12 CFR 1201.1, the nomenclature specified in that section. FHFA recently added part 1201 to contain definitions of terms that are used frequently throughout its regulations so as to eliminate the need to provide definitions for many common terms in multiple CFR parts.[37]

Section 1263.1 of the existing regulation defines the word "consolidation," which is used in various provisions of part 1263 to refer generically to any type of business combination of two or more institutions, to include "a consolidation, a merger, or a purchase of all of the assets and assumption of all of the liabilities of an entity by another entity." The proposed rule would revise that definition by substituting the phrase "substantially all" for the word "all" to reflect the fact that purchase and assumption transactions do not always involve or require the transfer of "all" assets and liabilities of the disappearing institution to the successor institution.

The rule would revise the definition of the term "regulatory financial report" to: remove reference to the "thrift financial report," which is no longer prepared; substitute the word "institution" for the word "applicant"; substitute the short form "NAIC" (to be defined separately) for the term "National Association of Insurance Commissioners"; change the reference to the insurance company regulatory "report" to the term "statement," which has a recognized meaning in the field of insurance regulation; and change the term "computer on-line database" to the more currently used term "electronic

[37] See 78 FR 2322 (Jan. 11, 2013).

database."

The existing regulation defines the term "long-term," which is used in the regulation as a modifier in the term "long-term home mortgage loan," to mean "a term to maturity of five years or greater." The proposed rule would revise that definition to make clear that "term to maturity" refers to the term established at the time of origination, and not to the remaining term to maturity at the time an institution acquires the loan or at any subsequent point.

The rule would also revise the definition of "residential mortgage loan" by replacing paragraph (5) (referring to "mortgage pass-through securities") and paragraph (6) (referring to "mortgage debt securities") with a new paragraph (5) intended to refer to both types of securities. The new provision would be similar to paragraph (2) of the proposed definition of "home mortgage loan," referring generally to a security representing either: (i) a right to receive a portion of the cash flows from a pool of loans meeting the requirements of one of paragraphs (1) through (4) of the definition of "residential mortgage loan"; or (ii) an interest in other securities representing such a right. This revision is not intended to effect any substantive change, but merely to streamline the definition in light of the fact that the proposed changes to the definition of "home mortgage loan" would make it unnecessary to distinguish between pass-through securities and other types of MBS in the definition of "residential mortgage loan." The rule would also redesignate paragraphs (7) and (8) of the definition as paragraphs (6) and (7), respectively, and would replace references to the various types of qualifying assets that are currently stated in the plural with the singular, as is the case in both the existing and proposed versions of the definition of "home mortgage loan."

Finally, the proposed rule would revise the definition of the term "total assets" to replace the term "CDFI applicant" with the term "CDFI," which is necessary because the key provisions of the proposed rule would apply to CDFI members on an ongoing basis, not just to CDFI applicants. This is consistent with the replacement of the word "applicant" with the word "institution" in the definition of "regulatory financial report" that is noted above. These changes are intended to reflect the fact that, under the proposed rule, a Bank would be required to determine an institution's total assets from its regulatory financial report or audited financial statement not only at the time of application, but also on an ongoing basis after the institution becomes a Bank member.

The proposed rule would also add definitions for the terms "CRA performance evaluation," "De novo insured depository institution," and "NAIC." Defining these terms will allow FHFA to remove lengthy and frequently repeated qualifiers currently used in conjunction with those terms from the substantive sections in which they appear. Thus, under the proposed rule, the term "CRA performance evaluation" is defined to refer to a formal evaluation if one is available for a particular institution and time period, and to an informal or preliminary evaluation when a final evaluation is not available. The term "de novo insured depository institution" is defined to refer to an insured depository institution that was chartered less than three years prior to applying for Bank membership. The acronym "NAIC" refers to the National Association of Insurance Commissioners.

B. Amendment of Substantive Provisions

1. Overview

The primary substantive revisions that the proposed rule would make to part 1263 are discussed above. In addition, the rule's revisions to the "makes long-term home mortgage loans" and "10 percent" requirements would require several conforming revisions to the regulatory text. Those revisions would: (1) establish the manner in which the Banks are to determine compliance with the ongoing eligibility requirements; (2) establish the manner in which, and the time within which, de novo insured depository institutions must comply with those requirements; (3) require the Banks to assess the financial condition of their insurance company members, based on their most recent audited financial statements; (4) establish a cure process, under which a member that fails to comply with the ongoing eligibility requirements would have one year to come into compliance; and (5) require the Banks to terminate the membership of any institution that has failed to comply with the ongoing requirements for a second consecutive year. Each of those provisions is discussed in more detail below.

2. Membership Application Process—§§ 1263.2-1263.5

The proposed rule would make several minor revisions to subpart B of part 1263, which governs the membership application process.

In order to make the revised provisions addressing the ongoing membership eligibility requirements under this proposed rule read more cleanly, FHFA is proposing to consolidate within subpart B those requirements that apply only to the membership application stage. Accordingly, the proposed rule would move from § 1263.6(a) (located in subpart C, which contains the provisions addressing the membership eligibility requirements) to the introductory clause of § 1263.2(a), the language that an institution may not become a member until it has submitted an application for membership that complies with the requirements of part 1263. In the existing regulation, § 1263.2(a) requires that an applicant for Bank membership submit to the Bank an application for membership that complies with the requirements of part 1263, but does not state explicitly that an institution may not become a member of a Bank unless it has done so.

Existing § 1263.2(c)(2) governs the documents that a Bank must include in each applicant's application file and membership digest. It requires that "[a]ll documents required by §§ 1263.6 to 1263.18" (i.e., the materials required to document the applicant's eligibility for membership) be described in and attached to the application digest that a Bank is required to maintain under § 1263.2(b). Under the proposed rule, both applicants for membership and existing members may be required to provide the Bank with certain documents pursuant to §§ 1263.6 to 1263.19 (as the eligibility provisions would be redesignated). In order to clarify that § 1263.2(c)(2) requires that only those documents pertaining to an application for membership be attached to and described in the application digest, FHFA is proposing to revise that paragraph to refer to "[a]ll documents required to be filed by an applicant under §§ 1263.6 to 1263.19."

Section 1263.3(c) of the existing regulation addresses the timing and notice requirements applicable to a Bank's decision on an institution's application for membership. The proposed rule would make a number of non-substantive revisions to that provision so that the requirements as to the timing of the Bank's decision read more precisely. No change in meaning is intended.

Section 1263.4 of the existing regulation addresses the circumstances under which an institution may be admitted to membership in a Bank "automatically"—that is, without the need to submit the type of full application that would otherwise be required. The proposed rule would make two minor wording changes to § 1263.4(a), which governs automatic membership for certain charter conversions, to make the provision read more clearly. No change in meaning is intended.

The proposed rule also would make certain clarifying changes to § 1263.4(b), which currently provides that any member whose membership is transferred pursuant to § 1263.18(d) shall automatically become a member of the Bank to which it transfers. Existing § 1263.18(d) (which the proposed rule would redesignate as § 1263.19(d)) provides that the transfer of membership from one Bank to another Bank may not take effect until the Banks involved agree on a method of orderly transfer or until FHFA determines the manner in which the transfer will occur in cases where the Banks involved fail to agree. Because neither § 1263.4(b) nor § 1263.18(d) specifies the types of events that constitute a "transfer" of membership, FHFA has occasionally received questions about how § 1263.4(b) is to be applied.

Under the proposed rule, § 1263.4(b) would no longer refer to a "transfer," but would instead state more specifically that if a member of one Bank relocates or redesignates its "principal place of business" to another Bank's district, it shall automatically become a member of the Bank whose district includes the state in which the member's new principal place of business is located. This is consistent with the existing regulation, which appears to allow for automatic membership if a member "redesignates" its principal place of business pursuant to § 1263.18(c) (which would appear as § 1263.19(c) in the proposed rule).

What is not clear from the current regulation is whether a member that "relocates" its home office, which is the default principal place of business for membership purposes, to another Bank district, such as through a merger or corporate reorganization, may also become a member of the new Bank automatically. Because the location of an institution's principal place of business determines where it may be a member, FHFA believes that any corporate transactions that result in a member's principal place of business being moved to another Bank district should allow for that member to become a member of the Bank where the new principal place of business is located. FHFA also has added qualifying language that the automatic membership at the new Bank commences upon the purchase of the minimum amount of stock needed under the new Bank's capital structure plan (hereinafter "capital plan").

Section 1263.5 of the existing regulation governs appeals to FHFA of a Bank's decision to deny membership to an applicant. The proposed rule would revise § 1263.5(a)(2) to show the new mailing address for FHFA. FHFA is not proposing any other revisions to this section, but requests comments on whether it should continue to permit applicants that have been denied membership by a Bank to appeal such denials to FHFA. The concept of an appeals process may have been appropriate after the Finance Board first delegated to the Banks the responsibility for approving or denying membership applications in 1996,[38] but is probably less necessary today, given the years of experience that the Banks have had in processing membership applications and the fact that FHFA is not aware of any instance in which an institution has exercised this right of appeal. FHFA also questions whether an institution that had been denied membership would be able to present facts sufficient to convince the agency to overturn the Bank's decision, particularly if the denial had been based on an assessment of the applicant's financial condition, which the Bank may be better suited to address. Although an applicant might contend that a Bank had misinterpreted a particular provision of the

---

[38] See 61 FR 42543 (Aug. 16, 1996).

membership regulation, FHFA has a separate process under which a Bank may request regulatory interpretations, and that process could serve as the means for resolving questions regarding the proper interpretation and application of the membership regulation in a particular case. FHFA also has an Office of the Ombudsman, which may hear complaints or appeals from any person that has a business relationship with a Bank (i.e., any existing or potential interaction between an applicant and a Bank), and which could provide an alternative means for addressing complaints about a Bank's decision to deny a membership application.[39]

3. Membership Eligibility Requirements—§§ 1263.6-1263.19

Subpart C of the existing regulation, which includes §§ 1263.6 through 1263.18, addresses the requirements that an institution must meet in order to be eligible for Bank membership. Section 1263.6 of the existing regulation sets forth the eligibility requirements for Bank membership. The remaining sections of subpart C address more specifically the manner in which a Bank is to determine an institution's compliance with the eligibility requirements that are set forth in § 1263.6.

a. General eligibility requirements—§ 1263.6

Section 1263.6 of the existing membership regulation sets forth the general membership eligibility requirements. The proposed rule would amend § 1263.6(a), as well as § 1263.6(b), to make clear that each of the membership eligibility requirements addressed in those provisions is ongoing and that institutions are expected to comply with them at not only the time they apply for membership, but also after attaining Bank membership. Existing § 1263.6(a) currently provides that an applicant must meet the

[39] See 12 CFR part 1213.

general eligibility requirements set forth therein in order to “become” a member of a Bank. Similarly, existing § 1263.6(b) provides that an applicant to which the “10 percent” requirement applies must meet that requirement in order to “become” a Bank member. The proposed rule would revise both of those provisions to state that an “institution” (as opposed to an “applicant”) must meet the requirements addressed in each in order to “be” (as opposed to “become”) a Bank member. Although FHFA considers all of the membership eligibility requirements to be ongoing in nature, the proposed rule would require a Bank to terminate membership only when a member has failed to comply with the “makes long-term home mortgage loans” or “10 percent” requirements, and then only after the member has been given an opportunity to cure its non-compliance. At this time, the agency believes that there are sufficient enforcement mechanisms in place—short of the ultimate sanction of termination—to ensure continuing compliance with the remaining eligibility requirements.[40]

---

[40] For example, under the existing membership regulation, an applicant for Bank membership must in most cases satisfy the “home financing policy” requirement by demonstrating that it has achieved a rating of “Satisfactory” or better on its most recent CRA evaluation. While the regulations do not require a member to maintain a “Satisfactory” or better CRA rating in order to retain its Bank membership, they do mandate restrictions on access to advances for failure to maintain such a rating. Under FHFA’s Community Support regulation, each Bank member is subject to a biennial “community support review,” under which the members selected for review for a particular time period are required to submit to FHFA a “community support statement” that reflects its most recent CRA rating and summarizes the activities it has undertaken in support of first-time home buyers. See 12 CFR 1290.2. Under that regulation, Bank members subject to CRA are expected to maintain a CRA rating of “Satisfactory” or better. A member that receives a CRA rating of “Substantial Non-Compliance” will (with some exceptions) have its access to long-term advances restricted by FHFA until that member again achieves a “Satisfactory” CRA rating. A member that receives a “Needs to Improve” rating will be given one CRA evaluation cycle to return to a rating of “Satisfactory” or better and, if it fails to do so at that time, will have its access to long-term advances restricted until it again achieves a “Satisfactory” CRA rating.

In addition, the “financial condition” eligibility requirement requires that an institution’s financial condition be such that advances may be safely made to it. Section 9 of the Bank Act and FHFA’s advances regulation permit a Bank to limit a member’s access to advances if its credit underwriting indicates that it is advisable to do so. 12 U.S.C. 1429 (a Bank may deny or conditionally approve requests for advances); 12 CFR 1266.4(a). The advances regulation also requires a Bank to limit or restrict access to advances in the case of a member that lacks positive tangible capital, but that has not yet reached the point of insolvency. 12 CFR 1266.4(b). The “duly organized” and “subject to inspection and regulation” eligibility

Because the proposed revisions would make clear that the "10 percent" requirement is ongoing, the proposed rule would also revise § 1263.6(b) to state explicitly that, as provided by statute, the "10 percent" requirement applies only to those non-CFI depository institutions that were not Bank members on January 1, 1989. The existing provision does not include such a reference because, since its promulgation in 1993, the requirement has been enforced only at the time of application and, therefore, applicants to which it has been applied would necessarily not have been Bank members on January 1, 1989.

The proposed rule would delete existing § 1263.6(c), which requires that an applicant that is not an insured depository institution—i.e., an insurance company or non-depository CDFI—have "mortgage-related assets" (a term that is not defined in the regulation) that reflect a commitment to housing finance, as determined by the Bank in its discretion. Among other things, the proposed new quantitative and ongoing "makes long-term home mortgage loans" requirement would provide a more specific and meaningful standard for measuring a non-depository institution's commitment to housing finance than the non-specific standard set forth in existing § 1263.6(c). Because of this, § 1263.6(c) would be rendered moot and thus could be repealed.

Existing § 1263.6(d) states that "[e]xcept as otherwise provided in this part, if an applicant does not satisfy the requirements of this part, the applicant is ineligible for membership." The proposed rule would redesignate the substance of this provision as § 1263.6(c)(1) and revise the wording to emphasize the need for continuing compliance

---

requirements are essentially self-enforcing in that any member that fell out of compliance with either of those requirements could not continue to operate as a financial institution.

with the ongoing eligibility requirements. The proposal also would remove the qualifier "except as otherwise provided in this part" as redundant (because the phrase "does not meet the requirements of this part" is intended to take into account the exceptions to the primary requirements), while adding the qualifier "except as provided in paragraph (c)(2)."

Proposed § 1263.6(c)(2) contains a new provision addressing the consequences to existing captive members of the new definition of "insurance company," which would make clear that captive insurers are ineligible for Bank membership. Paragraph (c)(2)(i) would permit any captive that had become a member prior to the publication date of this proposed rule to remain a member of its current Bank for five years following the effective date of the final rule. Because of the supervisory concerns, described above, associated with ineligible institutions using captives as funding vehicles for their own business operations, the proposed rule would bar a Bank from making or renewing any advance to such a captive if after doing so the total advances to the captive would exceed forty percent of its assets. It would further bar a Bank from making or renewing any advance with a maturity date after the end of the five year membership grace period to such a captive. The proposed rule would not prohibit a Bank from allowing outstanding advances to captives that were made or renewed prior to the effective date of the final rule from running to maturity, even if the maturity date falls after the end of the five year grace period.

Paragraph (c)(2)(i) is intended to mitigate to a reasonable extent the burden on any captive insurer that became a Bank member in good faith reliance on the existing membership regulation prior to the time FHFA provided notice, by means of this proposed rule, of its intention to limit Bank membership to insurance companies that primarily underwrite risks to nonaffiliated parties. The limitations on the terms to maturity of new and renewed advances and on the level of outstanding advances is intended to permit a grandfathered captive that chooses to remain a member during the grace period to continue to transact a reasonable amount of business with its district Bank, while limiting its ability to act as a conduit to funnel advance proceeds to affiliates that are themselves ineligible for Bank membership. Paragraph (c)(2)(ii) would require a Bank to terminate any such grandfathered captive members effective on the last day of the five year membership grace period, in the manner provided under § 1263.27.

If any captive insurer were to become a member of a Bank after the date of publication of this proposed rule, that entity would be ineligible to continue as a member of the Bank as of the effective date of the final rule, if adopted as proposed. In that case, FHFA would interpret the regulatory regime that would be in place on that date to require the immediate termination of that captive's Bank membership and prompt liquidation of any outstanding advances to that captive. In the event that any Bank approves a captive insurer for membership during the period between the publication of this proposed rule and the effective date of the final rule, FHFA will consider whether to make those requirements explicit in the final rule.

b. <u>"Makes long-term home mortgage loans" requirement—§ 1263.9</u>

Section 1263.9 of the existing regulation implements the "makes long-term home mortgage loans" requirement by stating that an applicant shall be deemed to make long-term home mortgage loans if, based on its most recent regulatory financial report, it originates or purchases long-term home mortgage loans.[41] The proposed rule would revise this section in two fundamental respects. First, it would establish a quantitative standard that each institution must meet in order to be deemed to make long-term home mortgage loans. Second, it would require that each member remain in compliance with the new quantitative standard on an ongoing basis in order to remain a member.

Specifically, § 1263.9(a) would provide that an institution shall be deemed to make long-term home mortgage loans, as required by the Bank Act and § 1263.6(a)(3), if it maintains at least one percent of its total assets in long-term home mortgage loans. Proposed § 1263.9(a) would also state explicitly that each Bank member must remain in compliance with this standard on a continuous basis.

Proposed § 1263.9(b) would address the method by which a Bank must assess each institution's compliance with the one percent asset ratio standard set forth in paragraph (a). Section 1263.9(b)(1) would specify that a Bank must calculate each member's and applicant's home mortgage loans-to-total assets ratio using three-year averages for both the numerator and the denominator, with all numbers being as of the end of the preceding three calendar years.

In cases where an institution has substantial mortgage banking operations—i.e., it originates loans for resale rather than for portfolio—its year-end balance sheet for any given year may not fully reflect its support for housing finance if it originated a substantial amount of home mortgage loans during the year that were then sold prior to year-end. FHFA believes that, given that the required HML-to-total asset ratio is only one percent and that the ratio is calculated based on average holdings over three year-

[41] In the case of a CDFI applicant that does not file regulatory financial reports, existing § 1263.9 permits the institution to establish its compliance by providing other appropriate documentation to the Bank.

ends, it is probably not necessary for the rule to require a Bank to take into account such "flow" business in determining whether an institution complies with the "makes long-term home mortgage loans" requirement. In addition, it is likely that most Bank members' regulatory financial reports will not contain the data necessary to determine the amount of the institution's flow business. Nonetheless, the agency requests comment on whether the final rule should include such a provision and, if so, how a Bank should be required to obtain the necessary data.

Proposed § 1263.9(b)(2) explains that the sources of the data for this calculation, and its required frequency and timing, are addressed in § 1263.11, which is a new provision that would be added as part of this proposed rule. As discussed below, proposed § 1263.11 would require a Bank to perform the calculation annually for each of its members, as well as at the time an institution applies for membership. It would further require the Bank to base its initial calculation on data obtained from an institution's regulatory financial report, but would permit the institution to provide data from certain alternative sources if it does not file a regulatory financial report or if the initial calculations failed to show that the institution was in compliance with the one percent standard. These requirements are addressed in a separate section because they are common to the calculation of both the home mortgage loans-to-total assets ratio and the residential mortgage loans-to-total assets ratio that would need to be calculated to determine compliance with the "10 percent" test under proposed § 1263.10.

One of FHFA's objectives in this proposed rulemaking is to identify a minimum amount of home mortgage loans at which an institution could be deemed to satisfy the "makes long-term home mortgage loans" requirement, i.e., a level at which an institution's mortgage loan holdings or originations can be considered to demonstrate the type of bona fide commitment to home mortgage lending that Congress intended when it adopted the "makes long-term home mortgage loans" requirement. FHFA considered a range of home mortgage loan-to-total assets ratios to be used as the minimum standard under this proposed rule, but several factors have driven the agency to propose a one percent ratio. First, FHFA believes that the one percent standard represents the lower bound for any range of percentages that could be used to assess an institution's commitment to home mortgage lending. Any institution that has less than one percent of its total assets in home mortgage loans clearly would not have the requisite commitment to home mortgage lending that Congress sought to support through the benefits of Bank membership.

Second, FHFA believes that the minimum level of home mortgage loans should not be so high as to require a significant number of members to materially alter their business and investment practices in order to retain their Bank membership. Finally, FHFA believes that whatever home mortgage loans-to-total assets ratio it adopts to implement the "makes long-term home mortgage loans" requirement must complement, but not conflict with, duplicate, or supplant, the "10 percent" residential mortgage loans-to-total assets ratio requirement. Because the range of assets that qualify as home mortgage loans is considerably more narrow than the range of assets that qualify as residential mortgage loans, any minimum asset ratio chosen for the "makes long-term home mortgage loans" requirement should be less than (and perhaps considerably less than) 10 percent of total assets. Otherwise, the minimum ratio for the "makes long-term home mortgage loans" requirement could effectively subsume the "10 percent" requirement. For example, requiring each member to hold 10 percent of its assets in home mortgage loans (which are a subset of residential mortgage loans) would effectively require all members to hold 10 percent or more of their assets in residential mortgage loans. That would conflict with the Bank Act, which requires that only non-CFI depository institution members must maintain 10 percent of their assets in residential mortgage loans.

Although FHFA is proposing to use one percent of total assets as the standard for compliance with the "makes long-term home mortgage loans" requirement, it also believes that it could establish a higher percentage without either supplanting the "10 percent" requirement or unduly burdening a significant number of existing members. The agency will continue to consider whether to establish the standard at some higher percentage, such as two percent, or possibly as high as five percent, as part of this rulemaking. To aid it in deciding this issue, FHFA requests public comments on whether setting the minimum required home mortgage loans-to-total assets ratio at a percentage greater than one percent of a member's total assets would be more consistent with the statutory intent and, if so, what the appropriate percentage should be in the final rule.

In attempting to determine an appropriate level at which to set the proposed quantitative standard, FHFA considered the possible consequences of requiring each member to maintain a minimum home mortgage loans-to-total assets ratio set at various levels between one and five percent. Based on information obtained from the December 31, 2013 regulatory financial reports of the Banks' insured depository institution members, FHFA determined that the vast majority of those members would have been in compliance even with an asset ratio requirement set as high as five percent, with most of those institutions holding home mortgage loans in amounts far in excess of that threshold.

More specifically, data obtained from the Federal Financial Institutions Examination Council 031 and 041 call reports (FFIEC call reports) filed by the 5,976 commercial banks and savings associations that were Bank members and for which information was available as of December 31, 2013 indicates that only 47 of those members, or 0.8 percent, would have failed to comply with a home mortgage loans-to-total assets ratio requirement of one percent, even based on that limited data. The same data indicated that 86 of those Bank members (or 1.4 percent) would have failed to comply with a quantitative standard set at two percent, while 299 (or 5.0 percent) would have failed to comply with a standard set at five percent. Data obtained from the December 31, 2013 NCUA 5300 call reports (NCUA call reports) filed by the 1,204 credit unions that were Bank members and for which information was available as of that date showed that only 14 credit union members (or 1.2 percent) would have failed to comply with a quantitative standard set at one percent, 29 (or 2.4 percent) would have failed to comply with a standard set at two percent, and 67 (or 5.6 percent) would have failed to comply with a standard set at five percent.

Although, relatively speaking, a much lower proportion of insurance company members would have been in compliance with a quantitative requirement set at any point between one and five percent, a majority of existing insurance company members would have been in compliance even with a five percent requirement, based on the 2013 year-end data. Data from the December 31, 2013 NAIC annual statements filed by 253 insurance company members with their state regulators indicated that 42 (or 16.6 percent) would have failed to comply with a quantitative standard set at one percent, 59 (or 23.3 percent) would have failed to comply with a standard set at two percent, and 105 (or 41.5 percent) would have failed to comply with a standard set at five percent.[42]

The agency currently lacks access to the data necessary to determine how many CDFI members could comply with an ongoing quantitative "makes long-term home mortgage loans" requirement.

Because those figures are based only on the portion of home mortgage loan assets that can be measured with accuracy from the members' respective call reports and annual statements, it is likely that a significant number of the institutions that appeared to fall short of the one, two, and five percent ratios based on that data alone would actually exceed those ratios once the assets that cannot be measured accurately from the call reports and annual statements are taken into account.[43] For example, while the NAIC annual statement provides data on loans secured by mortgages on one-to-four family or multi-family property held by an insurance company, it does not distinguish between those secured by first mortgages (which qualify as "home mortgage loans") and those

---

[42] FHFA was able to obtain annual statement data for only 253 of the 284 insurance companies that were Bank members as of December 31, 2013. Fourteen of the 29 insurance company members for which no data was available are captives. All three sets of data reflect the expanded definition of "home mortgage loan" that FHFA is proposing as part of this rule. If the existing definition is retained (i.e., if only pass-through securities are counted instead of all types of MBS backed by qualifying loans), the percentage of member institutions that would appear to be out of compliance based solely on data available from the regulatory financial reports would be somewhat higher.

[43] As explained in the discussion of proposed § 1263.11 below, it is not possible to determine from either the FFIEC call report, the NCUA call report, or the NAIC annual statement the precise amount of assets qualifying as "home mortgage loans" held by the reporting institution. However, it is possible in all cases to measure accurately the institution's holdings of certain types of home mortgage loan assets. Loans secured by first mortgages on one-to-four family residential properties and securities backed by mortgages on one-to-four family properties that are issued or guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac can be measured accurately from the FFIEC call report. Loans secured by first mortgages on one-to-four family residential properties and a portion of loans secured by first mortgages on multifamily properties can be measured accurately from the NCUA call report. Securities backed by mortgages on one-to-four and multi-family properties that are issued or guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac can be measured accurately from the NAIC annual statement.

secured by junior mortgages (which do not qualify). If even half of those whole loans were to be counted as home mortgage loans, the number of insurance company members appearing to be out of compliance would be much lower: 18 (or 7.1 percent) would have failed to comply with a quantitative standard set at one percent; 30 (or 11.9 percent) would have failed to comply with a standard set at two percent; and 79 (or 31.2 percent) would have failed to comply with a standard set at five percent. Thus, the latter figures may be more representative of the actual number of insurance company members that would have been out of compliance with a quantitative "makes long-term home mortgage loans" requirement than the figures listed above.

In addition, while the figures above are based upon the amount of home mortgage loans held by those members at one point in time, compliance with the quantitative standard would be based on the average amount of home mortgage loans held at the three preceding year-ends under the proposed rule. It is possible that the number of members failing to meet those hypothetical ratios might be lower still if average data from the preceding three year-ends had been used. In a similar fashion, of those institutions that would fail to meet the above quantitative requirements, some are only slightly below the particular threshold, which suggests that they could readily comply with an ongoing quantitative requirement by modestly adjusting their balance sheets.

c. "10 percent" requirement—§ 1263.10

Section 1263.10 of the existing membership regulation implements the statutory "10 percent" requirement. That provision states that an insured depository institution applicant to which the "10 percent" requirement applies shall be deemed to comply with that requirement if, based on its most recently filed regulatory financial report, the applicant has at least 10 percent of its total assets in residential mortgage loans. For purposes of determining compliance with the “10 percent” requirement, the existing regulation excludes from the asset ratio calculation assets held by the institution that would otherwise qualify as residential mortgage loans, but that have been pledged to secure mortgage debt securities. The proposed rule would replace nearly all of the text of existing § 1263.10.

Proposed § 1263.10(a) would provide that an institution shall be deemed to comply with the statutory and regulatory “10 percent” eligibility requirement if it maintains at least ten percent of its total assets in residential mortgage loans.

Proposed § 1263.10(b) addresses the method by which a Bank would determine whether an applicant or member maintains at least ten percent of its total assets in residential mortgage loans, as would be required under § 1263.10(a). The requirements of § 1263.10(b) would parallel those that would apply to determining compliance with the “makes long-term home mortgage loans” requirement, which are set forth in proposed § 1263.9(b).

Proposed § 1263.10(b)(1) specifies that, in determining whether an applicant or member to which the “10 percent” requirement applies maintains at least ten percent of its total assets in residential mortgage loans, a Bank must calculate the institution’s residential mortgage loans-to-total assets ratio using three-year averages for both the numerator and the denominator, with all numbers being as of the end of the preceding three calendar years. Like the existing regulation, proposed § 1263.10(b)(1) would also provide that loans or securities used to secure mortgage debt securities are not to be included in the amount of residential mortgage loans held for purposes of the “10 percent" requirement calculation. Proposed § 1263.10(b)(2) explains that the sources of the data for the "10 percent" requirement calculation, and the required frequency and timing of the calculations, are addressed in proposed § 1263.11.

FHFA examined December 31, 2013 call report data for 1,719 Bank members (515 banks and savings associations and 1,204 credit unions) that the agency estimates would have been subject to the proposed ongoing "10 percent" requirement as of that date in an attempt to estimate the number of such institutions that would have been out of compliance with an ongoing requirement. As is the case with measuring the amount of an institution's home mortgage loans from call report data, and as is discussed in more detail below, it is not possible to determine from either the FFIEC or NCUA call report the precise amount of assets qualifying as residential mortgage loans that are held by the reporting institution.

FHFA's analysis indicated that only a relatively few members would have been out of compliance with an ongoing "10 percent" requirement based on the call report data alone. That data indicated that all but 52 members (or 3.0 percent of those to which the requirement would apply) would have complied with the "10 percent" requirement if it had been applied to them as of that date. Of those institutions, 16 were commercial banks and savings associations (or 3.1 percent of the FDIC-insured institutions) and 36 were credit unions (or 3.0 percent of credit unions). Moreover, 15 of those 52 members had more than nine percent of their total assets in residential mortgage loans, while another 18 had between seven and nine percent of their total assets in residential mortgage loans. Thus, it is possible that the majority of members that appeared to be out of compliance based solely on the call report data might be still be able to comply with an ongoing requirement if given an opportunity to adjust their balance sheets or to identify additional residential mortgage loan assets that are not readily apparent from the call reports. It is also possible that the number of insured depository institutions failing to meet the 10 percent ratio might be lower still if data from the preceding three year-ends—as opposed to one point in time—had been used, as would be required in making the compliance determination under the proposed rule.

d. Timing of and standards for asset ratio calculations—§ 1263.11

The proposed rule would add to part 1263 a new § 1263.11, which would specify the required frequency and sources of data for the calculations to determine whether an institution maintains at least one percent of its total assets in home mortgage loans or, if applicable, maintains at least 10 percent of its assets in residential mortgage loans that are required under §§ 1263.9(b) and 1263.10(b), respectively. Proposed § 1263.11(a)(1) would provide that a Bank must determine whether an applicant maintains those minimum asset ratios at the time it considers that institution's application for Bank membership. In addition, proposed § 1263.11(a)(2) would require that a Bank determine whether each of its members is continuing to maintain those minimum asset ratios by performing the calculations required under §§ 1263.9(b) and 1263.10(b) once annually, as soon as practicable after the member's final regulatory financial report or audited financial statements for the preceding year become available.

Proposed § 1263.11(b) specifies the required sources of data for both the "makes long-term home mortgage loans" and "10 percent" asset ratio calculations. For insured depository institutions and insurance companies, proposed § 1263.11(b)(1) would require a Bank to obtain the data in the first instance from each institution's three most recently filed year-end regulatory financial reports. In cases where that data does not show the institution to be in compliance, a Bank would be permitted to accept a written certification from the institution's external auditor stating the actual amount of the relevant assets held by the institution on the appropriate dates and to use those figures as the basis for its calculation.

Proposed § 1263.11(b)(2) addresses the sources of data for asset ratio calculations relating to CDFIs that are not credit unions and that, therefore, do not file a regulatory financial report. It would require that, in performing those calculations for such a CDFI, a Bank obtain the relevant data from the CDFI's annual audited financial statements. If the data contained in the financial statements does not demonstrate compliance, then the proposed rule would permit the Bank to accept a written certification from the CDFI's external auditor stating the actual amount of the relevant assets held by the CDFI on the appropriate dates and to use those figures as the basis for its calculation. For any non-credit union CDFI with average total assets of less than $100 million over the three preceding year-ends, a Bank would be permitted to use a written certification prepared by an executive officer of the CDFI, in lieu of a certification from the external auditor.

Proposed § 1263.11(c) provides that, in determining the amount of an institution's long-term home mortgage loans or residential mortgage loans for purposes of the required asset ratio calculations, a Bank shall follow guidance issued by FHFA regarding the derivation of data from particular types of regulatory financial reports, including the extent to which particular schedules or line items may be used to determine the amount of an institution's home mortgage loans or residential mortgage loans. Because regulatory financial reports are subject to change by the financial institution regulators, FHFA expects that it will need to issue guidance periodically to address any questions about how the Banks are to extract the relevant data from those reports.

FHFA's primary intent in requiring a Bank to use regulatory financial reports for the calculations required under proposed §§ 1263.9(b) and 1263.10(b) is to minimize, and in most cases to eliminate, the need for Bank members to take any action to prove their compliance with the proposed ongoing asset ratio requirements. This approach should also minimize the administrative burden on the Banks associated with performing one or both of those calculations. The regulatory financial reports are readily available to the Banks, who should be able to confirm compliance with the asset ratio requirements through that report data for the vast majority of their members. Most, and possibly all, of the Banks already rely on data drawn from the FFIEC and NCUA call reports to ascertain the level of "residential housing finance assets" held by their insured depository institution members in determining whether those members are in compliance with the "proxy test" requirement imposed by § 1266.3(b) of FHFA's advances regulation.[44] Although initially it will likely require some time and investment for each Bank to develop systems to extract the appropriate data and to run the required calculations, once that has been accomplished, the Banks should be able to conduct the annual calculations without undue burden.

[44] The advances regulation provides that a Bank may make long-term advances (i.e., those with an original term to maturity greater than five years) only for the purpose of enabling a member to purchase or fund "residential housing finance assets" (a term that is defined in § 1266.1 of the advances regulation). See 12 CFR 1266.3(a). To implement that requirement, the regulation further requires that, prior to approving an application for a long-term advance to a member, a Bank determine that the principal amount of all long-term advances currently held by that member does not exceed the total book value of residential housing finance assets held by such member. See 12 CFR 1266.3(b). That calculation, which is commonly referred to as the "proxy test," is intended to provide a rational means of measuring compliance with the regulation, while recognizing the fungible nature of money.

One drawback of relying upon data drawn from members' regulatory financial reports is that none of the types of reports filed by Bank members—i.e., the FFIEC call report filed by FDIC-insured commercial banks and savings associations, the NCUA call report filed by credit unions, or the NAIC annual statement filed by insurance companies with their state regulators—provides sufficient information for a Bank to determine accurately the full amount of home mortgage loans or residential mortgage loans held by the reporting institution. Each of those three reports contains one or more schedules comprising numerous line items that break down the reporting institution's balance sheet assets with varying degrees of specificity. In each of the reports, certain assets that qualify as either a home mortgage loan or as a residential mortgage loan are reported on line items that may include other assets that do not qualify. In those cases, it is not possible to determine the portion of the total dollar amount reported for the line item that represents the amount of qualifying assets held by the reporting institution. However, each of the three reports contains one or more line items that includes only assets that qualify as either a home mortgage loan or a residential mortgage loan and, therefore, permits a reliable measurement of at least a portion of the qualifying assets held by the reporting institution. If a Bank can determine from those line items alone that a particular member holds at least the required ratio of home mortgage loans or residential mortgage loans to total assets, then it need not inquire any further, i.e., it need not determine the full amount of the member's qualifying assets, to comply with the regulation.

Two types of assets that are likely to represent a significant amount of most commercial banks' and savings associations' home mortgage loan holdings can be measured accurately from the FFIEC call report: (1) loans secured by first mortgages on one-to-four family residential properties; and (2) securities issued or guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac representing an interest in first mortgage loans on one-to-four family properties. The line item categories reflected in the NCUA call reports differ from those in the FFIEC call reports and are broken down in such a way that makes it more difficult to measure accurately the level of home mortgage loans held by a credit union. However, loans secured by first mortgages on one-to-four family residential properties and a portion of loans secured by first mortgages on multifamily properties can be measured accurately from the NCUA call report.

It is easier to measure accurately from call report data the amount of residential mortgage loans held by a reporting institution, because the specific assets that fall within the regulatory definition of that term are broader and more numerous than those that fall within the definition of home mortgage loan and, therefore, more line items on both the FFIEC and NCUA call reports include assets qualifying as residential mortgage loans without also including assets that do not qualify. For example, with the exception of MBS backed by mortgage loans on multi-family properties, a Bank could accurately measure from the FFIEC call report all of the major categories of residential mortgage loan assets that are likely to be held by most commercial banks and savings associations. While the NCUA call report does not contain as many different categories as the FFIEC call report, it is possible to measure accurately a majority of the primary categories of residential mortgage loan assets from that report.

As discussed above, FHFA drew data from recently filed call reports of existing insured depository institution members and annual statements of existing insurance company members to measure, to the extent possible, the amount of home mortgage loans and, for those institutions that would be subject to an ongoing "10 percent" requirement, the amount of residential mortgage loans held by such members. The purpose of that exercise was not only to estimate the number of existing members that would not meet the proposed ongoing asset ratio requirements, but to determine whether the FFIEC and NCUA call reports and the NAIC annual statements could be used as a reliable source for monitoring members' compliance with the ongoing requirements. The fact that FHFA could determine from the call report data that all but a small percentage of insured depository institution members would comply with both of the proposed ongoing asset ratio requirements indicates that the FFIEC and NCUA call reports can be used to confirm compliance with those requirements for the vast majority of the Banks' insured depository institution members.

Although data drawn from the NAIC annual statements indicated that a higher percentage of insurance company members than insured depository institution members would have been out of compliance with the one percent home mortgage loans-to-total assets requirement, this appears to be due to the fact that those insurance companies are actually holding fewer home mortgage loans and not because it is any more difficult to measure those holdings from the NAIC annual statements than it is from the FFIEC and NCUA call reports. A Bank would be able to use the annual statement to measure an insurance company's holdings of MBS issued or guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac and backed by first mortgage loans on one-to-four family or multifamily properties. Those types of agency securities appear to make up the predominant portion of home mortgage loan assets held by most insurance companies. Consequently, FHFA believes that the NAIC annual statement would serve as a reliable source for a Bank to confirm compliance with the proposed ongoing quantitative "makes long-term home mortgage loans" requirement for the majority of its insurance company members. Because insurance company members are not subject to the "10 percent" requirement, there is no need to determine the amount of their residential mortgage loans.

CDFI members, other than those that are credit unions, do not have a prudential federal or state regulator, nor do they file periodic regulatory financial reports that provide information about their holdings of home mortgage loans. For that reason, the proposed rule would require a Bank to look first to a CDFI member's audited financial statements to assess its compliance with the quantitative "makes long-term home mortgage loans" requirement. If the audited financial statements do not provide sufficient information to determine compliance, then § 1263.11 of the proposed rule would allow a Bank to accept a written certification from the CDFI's external auditor attesting to the actual amounts of its total assets and home mortgage loans. For CDFIs with assets less than $100 million, the proposed rule would allow a Bank to accept a certification from an executive officer in lieu of one from the external auditor.

Most, if not all, of the Banks already have systems and procedures in place to obtain regular periodic certifications from members as to the amounts of their residential housing finance assets for purposes of complying with the "proxy test" for obtaining long-term advances. A number of Banks require their insurance company and CDFI members to self-certify as to their holdings of such assets, typically by completing a form on which the member lists the value of its holdings of each of the various categories of qualifying assets. The Banks could modify these existing processes and procedures to include requests for and receipt of the auditor or executive officer certifications that would be required under the rule.

e. Treatment of de novo insured depository institutions—§ 1263.15

Section 1263.14 of the existing membership regulation addresses the treatment of a “de novo applicant,” which it defines as an insured depository institution chartered less than three years prior to the date it applies for Bank membership. The existing regulation deems each de novo applicant to be in compliance with the “duly organized,” “subject to inspection and regulation,” “financial condition,” and “character of management” eligibility requirements, which reflects the fact that the chartering entity and the federal deposit insurer would have evaluated those areas in connection with granting the charter and approving the de novo insured depository institution for deposit insurance. The existing regulation also allows a de novo applicant to satisfy the “makes long-term home mortgage loans” requirement by providing a written justification acceptable to the Bank of how its home financing credit policy and lending practices will include originating or purchasing long-term home mortgage loans.

As required by statute, existing § 1263.14 also deems a de novo applicant to which the “10 percent” requirement applies and that has been in operation for less than one year to be in “conditional compliance” with that requirement at the time of application, and grants the institution “conditional membership” until the institution reaches the one-year anniversary of its commencement of operations. At that point, if the institution provides evidence acceptable to the Bank that it holds at least 10 percent of its assets in residential mortgage loans, it is considered to be in full compliance with the “10 percent” requirement and its membership status ceases to be conditional. If the institution is unable to provide such evidence, its conditional membership is terminated and its membership stock is redeemed in accordance with the procedures specified in that section.

Similarly, existing § 1263.14 allows any de novo applicant that has not yet received its first CRA performance evaluation to achieve conditional compliance with the "home financing policy" requirement by providing a written justification acceptable to the Bank of how and why its home financing credit policy and lending practices will meet the credit needs of its community. Again, the existing regulations grant the institution "conditional membership" until the institution receives its first CRA evaluation. If the institution receives a "Satisfactory" or better rating on its first CRA evaluation, it is deemed to be in full compliance with the "home financing policy" requirement. If it fails to achieve a "Satisfactory" rating on that evaluation, it is considered to be out of compliance (unless that presumption is rebutted as specified in the regulation) and its conditional membership is terminated.

The proposed rule would significantly revise several of the provisions relating to de novo insured depository institutions and would replace them with a new section, to be designated as § 1263.15. To make clear that the time-limited exceptions for entities formed within the preceding three years apply only to insured depository institutions (as is the case in the existing regulation), proposed § 1263.15 would refer throughout to a "de novo insured depository institution," instead of shortening that term to "de novo applicant" as existing § 1263.14 does. As is the case with the existing membership regulation, the proposed rule would not modify the membership eligibility requirements in any way for recently formed insurance company or CDFI applicants or members.

Proposed § 1263.15(a) would retain the substance of the existing regulation by deeming a de novo insured depository institution applicant to be in compliance with the "duly organized," "subject to inspection and regulation," "financial condition," and "character of management" requirements. Like the existing regulation, proposed § 1263.15(b)(1) would also deem such a de novo applicant to have initially satisfied the "makes long-term home mortgage loans" requirement by providing a written justification acceptable to the Bank of how its home financing credit policy and lending practices will include originating or purchasing long-term home mortgage loans. Because the proposed rule would separately require all members to comply with the "makes long-term home mortgage loans" requirement on an ongoing basis, however, the period of time during which a de novo insured depository institution could rely on this presumed compliance would be limited. Proposed § 1263.15(b)(2) would allow a de novo insured depository institution to rely on the presumptive compliance provision only until it files with its regulator its first year-end regulatory financial report following the one year anniversary of its attaining membership. For example, if a de novo insured depository institution were to become a member in November 2014, the period of initial compliance would end when the regulatory financial report for December 2015 became available to the Bank. For de novo insured depository institutions becoming members earlier in 2014, the period of initial compliance also would end when the regulatory financial report for December 2015 became available. Although this period of initial compliance may vary from institution to institution, depending on the date of membership, it will be at least one year for all de novo insured depository institutions.

Once the de novo insured depository institution files its first year-end regulatory financial report following the one year anniversary of the date it became a member, the rule would require a Bank to determine the member's compliance with the "makes long-term home mortgage loans" one percent asset ratio standard based on the amount of home mortgage loans and total assets held by that member at the end of the year covered by that call report. At that point, the Bank would not determine the member's compliance with the asset ratio based on three year averages as it would be required to do for other members, even if the member actually had three or more years of financial data available. In the following year, the Bank would determine compliance for that member based on averages from the two preceding year-ends. In subsequent years, the de novo provisions would cease to apply and the member would be treated in the same manner as all other members—i.e., the Bank would assess its compliance based on rolling three year averages as provided in proposed § 1263.9(b). If a member that had been deemed to be in compliance with the "makes long-term home mortgage loans" requirement under the de novo provisions of § 1263.15(b)(1) later fails to meet the requirements of § 1263.9(b), modified as described, it would become subject to the same sanctions and procedures as any other member that fails to comply with the "makes long-term home mortgage loans" requirement.

With respect to the "10 percent" requirement, the proposed rule would parallel the existing rule, which implements a statutory provision allowing de novo insured depository institutions up to one year from the date that they commence their business operations to comply with that requirement. Thus, proposed § 1263.15(c) would deem a de novo insured depository institution to be in compliance with the "10 percent" requirement at the time of application and thereafter, until one year after the institution commenced its operations. Subsequently, the rule would require that the Bank determine compliance for that member as specified in § 1263.10, which addresses compliance for all other institutions to which the "10 percent" requirement applies. Similar to its treatment of de novo insured depository institutions' compliance with the "makes long-term home mortgage loans" requirement, the rule would permit the Bank to determine compliance based on the actual number of year-end regulatory financial reports filed by the member since commencing its operations, for those cases in which a member had not yet filed three year-end regulatory financial reports by the time that it became subject to proposed § 1263.10.

Although worded somewhat differently than existing § 1263.14(d), proposed § 1263.15(d) would treat the compliance of a de novo insured depository institution with the "home financing policy" requirement in the same manner as the existing regulation. Thus, under both the existing regulation and the proposed rule a Bank may conditionally approve a membership application from a de novo insured depository institution based on the applicant's written justification, but that approval will become null and void if the member's first CRA performance evaluation is either "Needs to Improve" or "Substantial Non-Compliance."

Proposed § 1263.15(e) provides that a de novo insured depository institution member that is deemed to have complied with the eligibility requirements for membership as provided under § 1263.15 and that achieves membership on that basis, is subject to all regulations applicable to members generally, including those relating to stock purchase requirements and advances or collateral, notwithstanding the possibility that its membership may be conditional for some period of time. It further provides that if a de novo insured depository institution's conditional membership is terminated due to a failure to comply with the post-membership eligibility requirements of proposed § 1263.15, then the Bank must liquidate any outstanding indebtedness and redeem or repurchase its capital stock as it would for any other member in accordance with § 1263.29. The substance of this provision is similar to provisions in the existing regulation, which requires compliance with stock purchase requirements, advances regulations, and redemptions or repurchases of Bank capital stock.

f. Financial condition of CDFIs and insurance companies—§ 1263.17

The proposed rule would redesignate § 1263.16 of the existing regulation, which governs the application of the "financial condition" requirement of § 1263.4(a)(4) to insurance company and certain CDFI applicants, as § 1263.17. As mentioned above, existing § 1263.6(a)(4) provides that, in order to be eligible for Bank membership, an institution's financial condition must be "such that advances may be safely made to it." The Bank Act applies this "financial condition" requirement only to insured depository institutions that were not Bank members on January 1, 1989.[45] However, both FHFA and the Finance Board have applied this requirement by regulation to all institutions, including insurance companies, as a matter of safety and soundness.[46] This approach would be carried over in the proposed rule.

Under existing § 1263.16(a), an insurance company applicant is deemed to meet the "financial condition" requirement if the Bank determines, based on the information contained in the applicant's most recent regulatory financial report, that it meets all of its minimum statutory and regulatory capital requirements and, in addition, meets all

[45] See 12 U.S.C. 1424(a)(2)(B).
[46] See 58 Fed. Reg. 43522, 43531-43534 (1993) (discussion in preamble to Finance Board's first post-FIRREA final rule on Bank Membership of the agency's decision to apply the requirements of Bank Act § 4(a)(2)(B) to insurance companies, as well as insured depository institutions).

applicable capital standards established by the NAIC, regardless of whether those NAIC standards have been adopted by the state in which the company is subject to regulation.[47] The proposed rule would carry forward those requirements, but would also require a Bank to review an insurance company's most recent audited financial statements and to determine that its financial condition is such that the Bank can safely make advances to it before that applicant may be deemed to meet the "financial condition" requirement. Proposed § 1263.17(a)(2) would require that the Bank make the latter determination based upon audited financial statements prepared in accordance with generally accepted accounting principles (GAAP), if available. If no such financial statements are available, the proposed rule would permit a Bank to use financial statements prepared in accordance with statutory accounting principles.

Under the existing regulation, the standards that an insured depository institution must meet in order for a Bank to determine that it complies with the "financial condition" requirement are more robust than those that apply to insurance companies. For insured depository institution applicants, a Bank must examine multiple sources of information and, in the case of applicants that have not received a regulatory examination rating of "1", to determine from those sources whether the applicant has met particular financial

[47] As explained by the Finance Board when it first adopted this provision in 1996, "[w]hile not all states have yet adopted the NAIC capital standards, the Finance Board believes these are a useful measure of an insurance company's financial condition." See 61 Fed. Reg. 42531, 42540 (Aug. 16, 1996). For example, the NAIC adopted the most recent version of its Risk-Based Capital (RBC) for Insurers Model Act in 2011. As of January 2014, only 14 out of 56 states and territories had adopted RBC requirements that were substantially similar to those in the 2011 version of the RBC for Insurers Model Act. Section 1263.16(a) requires a Bank to determine that an insurance company applicant meet the standards set forth in the Model Act, even if the applicant is subject to regulation in one of the 42 jurisdictions that has not adopted those standards. In those jurisdictions, the Bank is also required to determine that the applicant meets the capital standards that have actually been adopted.

metrics.[48] FHFA is considering adding additional components to the "financial condition" requirement for insurance companies that are analogous to those that currently apply to insured depository institutions. The agency requests comments on what type of metrics or other criteria would be appropriate indicators that an insurance company is in a financial condition such that advances may be safely made to it and how such metrics or benchmarks should reflect the business models and risks insured by different types of insurance companies.

Existing § 1263.16(b), which sets forth the criteria for deemed compliance with the "financial condition" requirement for CDFIs other than CDFI credit unions, would be retained without change as § 1263.17(b) under the proposed rule.

g. Determining appropriate district for Bank membership—§ 1263.19

The proposed rule would redesignate existing § 1263.18, which sets forth standards applicable to determining the appropriate Bank district for membership, as § 1263.19. Apart from the revisions noted below, the substance of the proposed rule would

[48] Existing § 1263.11 enumerates the materials that a Bank must review when considering whether an insured depository institution or CDFI credit union meets the "financial condition" requirement and sets forth the financial benchmarks that such applicants must meet in order to be deemed to meet that requirement. For those types of applicants, the regulation generally requires a Bank to review: (1) regulatory financial reports for the last six calendar quarters and three year-ends; (2) the most recent audited financial statements, prepared in accordance with GAAP (if available); (3) the most recent available regulatory examination report; (4) a report prepared by the Bank or applicant on any outstanding enforcement actions against the applicant; and (5) any other relevant information concerning the applicant that comes to the Bank's attention. See 12 CFR 1263.11(a). A depository institution or CDFI credit union will be deemed to meet the "financial condition" requirement if it meets all of its minimum statutory and regulatory capital requirements as reported in its most recent quarter-end regulatory financial report and its most recent composite regulatory examination rating (which must have been received within the past two years) was "1". It may still be deemed to comply with the "financial condition" requirement if its examination rating was" 2" or "3" so long as: (A) its adjusted net income was positive in four of the six most recent calendar quarters; (B) its nonperforming loans and leases plus other real estate owned, did not exceed 10 percent of its total loans and leases plus other real estate owned, in the most recent calendar quarter; and (C) its ratio of allowance for loan and lease losses plus the allocated transfer risk reserve to nonperforming loans and leases was 60 percent or greater during four of the six most recent calendar quarters. See 12 CFR 1263.11(b). Section 1263.11 would be redesignated as § 1263.12 under the proposed rule, but would otherwise remain unchanged.

be the same as that of the existing regulation. Existing § 1263.18(a)(1) implements section 4(b) of the Bank Act by providing that an institution may become a member only of the Bank of the district in which the institution's "principal place of business" is located.[49] The proposed rule would revise the existing provision slightly to state that an institution "may be a member," rather than "may become a member" only of the Bank of the district in which the institution's principal place of business is located. FHFA and its predecessor agencies have consistently construed section 4(b) as prohibiting a member of a particular Bank from remaining a member of that Bank after it has relocated or redesignated its principal place of business to another Bank district. The revised provision, which appears as § 1263.19(a)(1) in the proposed rule, would more accurately reflect the manner in which section 4(b) has been applied historically and continues to be applied.

Existing § 1263.18(b) provides that, unless otherwise designated in accordance with the regulation, the "principal place of business" of an institution is the state in which it maintains its home office, as so designated in accordance with the laws under which it is organized. Proposed § 1263.19(b) would retain that language regarding the home office, but would add a second component requiring that the institution conduct business operations from the home office in order for that state to be considered as its principal place of business. This proposed revision is intended as a conforming change related to the addition of a new § 1263.19(f) and is explained in greater detail below in the context of the discussion of the latter provision.

[49] Section 1263.18(a)(2) of the existing rule implements an alternative provided by section 4(b) of the Bank Act, which allows an institution to become a member of the Bank of a district adjoining the one in which the institution maintains its principal place of business, but only if that is demanded by convenience and approved by FHFA. See 12 U.S.C. 1424(b).

Existing § 1263.18(d)(1) deals with transfers of membership from one Bank to another Bank and provides that no such transfer shall take effect until the Banks involved reach an agreement on a method of orderly transfer. The proposed rule would revise this provision, which would appear as § 1263.19(d)(1), to clarify that it applies to instances where a member of one Bank either redesignates or relocates its principal place of business to a state located in another Bank district. A "redesignation" of a principal place of business can occur if a member satisfies a three-part test set out in § 1263.18(c) of the current regulation, which would be carried over into the proposed regulation without change as § 1263.19(c). A "relocation" of a member's principal place of business would occur if it were to relocate its home office, as identified in its charter, to another state, such as in connection with a corporate reorganization, merger, or acquisition. This change is intended to reflect the two methods by which transfers of membership can occur and is related to the revisions that would be made to § 1263.4(b) of the proposed rule, regarding "automatic membership" that can occur as a result of such transfers of a member's principal place of business.

The proposed rule includes a new paragraph § 1263.19(f) that would address how the Banks are to determine the "principal place of business" for insurance companies or CDFIs that cannot satisfy the general requirements for determining an institution's principal place of business. Accordingly, the Banks would use this provision only if an institution does not have an actual "home office" established under the laws of its chartering statute, or it has such a "home office" but does not conduct business operations from that location, or it cannot satisfy the three-part test of proposed § 1263.19(c) for designating its principal place of business.

Section 1263.19(f) would provide that for an insurance company or CDFI that cannot satisfy the general requirements for establishing its principal place of business the Bank shall designate as the principal place of business the geographic location from which the entity actually conducts the predominant portion of its business activities. Banks must make those determinations based on the totality of the circumstances and an assessment of objective factors that indicate the most likely location at which the institution conducts its business, such as the location from which the institution's senior officers direct, control, and coordinate its activities, or the locations from which the institution conducts its business.

For cases in which an insurance company maintains no physical offices of its own and has no employees of its own, which may occur if the company contracts out the actual operation of the insurance business to affiliated insurance companies or to third parties, or if its senior officers are located at multiple locations in different states, the proposed rule would require the Banks to designate the state of domicile as the principal place of business. That provision is intended to address only those narrow situations in which the factors that a Bank might otherwise use to establish the insurance company's principal place of business are absent, i.e., if the company's senior officers are situated in different locations, or it has no physical office buildings or employees of its own. In all such cases, a Bank would have to demonstrate how it determined that the insurance company had no other objective factors—i.e., offices, employees, or senior officers—that would establish one geographic location as the place from which the entity could be deemed to conduct the predominant part of its business operations.

As mentioned above, in a related amendment, the proposed rule would revise §

1263.19(b), which provides that an institution's principal place of business for membership purposes generally is deemed to be its "home office," if designated as such by its charter or articles of organization. The proposal would add to this provision language requiring that an institution also actually conduct business operations from its home office in order for it to be deemed to be its principal place of business. The intent of that revision is to make clear that an institution cannot have a "principal place of business" at a particular location without actually conducting some business operations from that location. A mere legal presence, such as a statutory home office or a registered agent's office at which no insurance business is conducted, is not sufficient by itself to constitute a company's principal place of business for Bank membership purposes. This revision should not affect insured depository institution members because the home office that is designated in their charters will typically also be a branch office from which some banking business will be conducted, which would satisfy the revised regulation. FHFA intends that these amendments to the principal place of business regulation would apply prospectively, and thus would not affect any existing Bank members.

FHFA is proposing these revisions to address questions that have arisen about how to determine the principal place of business for insurance companies and CDFIs that may not operate in the state under whose laws they are organized or who do not have a statutorily established home office. In 2012, FHFA issued a regulatory interpretation addressing whether a non-depository institution could establish its principal place of business for Bank membership purposes based solely on its state of incorporation.[50] FHFA opined that the location of an institution's principal place of business is largely a

[50] FHFA Regulatory Interpretation 2012-RI-02 (April 3, 2012).

question of fact that Banks should resolve by identifying the geographic location from which the institution actually conducts its principal business operations. Recently, FHFA declined a request to allow the Banks to look solely to the state of domicile to identify the principal place of business for insurance company members.

The regulation and regulatory interpretation reflect a statutory requirement that an institution may become a member only of the Bank for the district in which the institution has its principal place of business.[51] Because the Bank Act does not define "principal place of business," FHFA may do so, provided that its definition is consistent with the language and purposes of the Bank Act. In determining how broadly it may construe the term "principal place of business," FHFA considered the recent opinion of the United States Supreme Court in Hertz Corp. v. Friend,[52] which construed that term for purposes of another federal statute.[53] In that case, the Court determined that a corporation's principal place of business would be the location from which its senior officers "direct, control, and coordinate the corporation's activities." Ordinarily, that would be the corporate headquarters, provided that the headquarters actually were used as the center of direction, control, and coordination. In parsing the statutory language, the Court reasoned that the word "place" meant that there had to be a single location, and that the word "principal" meant that courts should "pick out the 'main, prominent' or 'leading' place" of a corporation's business.

---

[51] 12 U.S.C. 1424(b). That provision also allows an institution to become a member of a Bank whose district adjoins the Bank district in which the institution's principal place of business is located, but only if "demanded by convenience" and approved by FHFA. FHFA is not aware of any institution ever being approved for membership under this provision.

[52] 559 U.S. 77 (2010).

[53] In the Hertz case, the Court construed the term "principal place of business" as it appears in the federal diversity jurisdiction statute, which provides that a corporation is deemed to be a citizen of the "State by which it has been incorporated and of the State where it has its principal place of business." See 28 U.S.C. 1332(c)(1).

FHFA believes that it should construe the Bank Act's reference to a member's "principal place of business" in a similar manner to the way that the Supreme Court has construed that term. Thus, in order for an insurance company or CDFI member or applicant for membership to have its "principal place of business" at a particular location the institution must actually conduct business at that location and the activities conducted at that location should be greater in some respect than at any of its other business locations. Requiring the Banks to look to the geographic location from which an insurance company or CDFI conducts the predominant portion of its business is consistent with the plain language of the statute as well as with the Hertz Court's reasoning.

By comparison, it does not appear that looking solely to an insurance company's state of domicile or a CDFI's state of incorporation would be consistent with that reasoning because it would not ensure that the location so designated as the institution's "principal place of business" would in fact be the "main or prominent" place from which it conducts its business. That is so because some states' laws allow their insurance companies and other business corporations (which would include CDFIs) to conduct all of their business activities in other states. Because an approach that looks solely to the state of domicile or the state of incorporation to determine "principal place of business" would allow for the possibility that an insurance company or CDFI could be deemed to have its principal place of business at a location at which it actually has no place of business, FHFA does not believe that it can construe the statute that broadly.

h. Other revisions to eligibility provisions in subpart C

In addition to the major substantive revisions to subpart C that are discussed above, the proposed rule would also make other more minor revisions to a number of other sections dealing with various aspects of the Bank membership eligibility requirements.

The proposed rule would revise both § 1263.7, which implements the "duly organized" requirement, and § 1263.8, which implements the "subject to inspection and regulation" requirement, to substitute the word "institution" for the word "applicant." Those revisions would conform the text of those provisions to that of the provisions implementing the "makes long-term home mortgage loans" and "10 percent" requirements, both of which refer to "institutions" rather than "applicants" because they would be applied on an ongoing basis.

The proposed rule would redesignate existing § 1263.11, which implements the "financial condition" requirement for insured depository institutions and CDFI credit unions, and existing § 1263.12, which implements the "character of management" requirement, as §§ 1263.12 and 1263.13, respectively, but would otherwise leave those sections unchanged. The proposed rule also would redesignate existing § 1263.13, which implements the "home financing policy" requirement, as § 1263.14. In addition, the rule would revise that provision to substitute the word "institution" for the word "applicant" and to substitute the newly defined term "CRA performance evaluation" for the more cumbersome phrase "formal, or if unavailable, informal or preliminary, CRA performance evaluation." Under the proposed rule, those modifiers are included in the definition of the term "CRA performance evaluation" and, therefore, need not be repeated in the remainder of the rule text.

Section 1263.15 of the existing regulation specifies the manner in which the

Banks must apply the "financial condition," "home financing policy," "makes long-term home mortgage loans," and "10 percent" requirements to applicants that have recently merged with or acquired another institution. The proposed rule would redesignate that section as § 1263.16 and would also make a number of non-substantive revisions to provide greater clarity, with no change in meaning intended. The existing regulation currently allows a recently combined applicant that has not yet filed a consolidated regulatory financial report to use the pro forma combined financial statements filed with the regulator that approved the merger or acquisition, for purposes of complying with the "makes long-term home mortgage loans" and "10 percent" requirements. In order to reflect the ongoing nature of those two requirements, the proposed rule would add a sentence to proposed § 1263.16(c) that makes clear that subsequent compliance with those eligibility requirements is to be determined based on the post-merger regulatory financial reports filed by the combined entity.

The proposed rule would redesignate existing § 1263.17, which sets forth rebuttable presumptions to be applied in determining whether an applicant for Bank membership complies with certain statutory and regulatory eligibility requirements, as § 1263.18. The rule would also make certain non-substantive revisions to the text of that section in order to improve clarity, but otherwise would leave it substantively unchanged.

4. <u>Bank stock requirements—§§ 1263.20-1263.23</u>

Subpart D of part 1263 currently sets forth certain requirements regarding the purchase and disposition of Bank stock. The proposed rule would repeal several provisions within this subpart that relate to the capital structure of the Banks prior to the enactment of the Financial Services Modernization Act of 1999[54] (hereinafter, the "Gramm-Leach-Bliley Act" or "GLB Act"), which, among other things, amended the Bank Act to require each Bank to establish and operate under a capital plan meeting certain specified standards.[55] Those regulatory provisions no longer have any relevance or effect because all of the Banks are now operating under GLB Act capital plans. The provisions to be repealed are: (1) § 1263.19, which requires Bank capital stock to be sold at par unless the Director has fixed a higher price; (2) portions of § 1263.20 relating to the pre-GLB Act subscription capital requirements; (3) § 1263.21, pertaining to the issuance and form of Bank stock, primarily under the pre-GLB Act regime; and (4) portions of § 1261.22 relating to the redemption of excess shares of pre-GLB Act capital stock. The proposed rule would retain the substance of the remaining provisions of existing subpart D, although those provisions would be organized differently and would be revised to reflect the GLB Act capital provisions more explicitly.

As proposed, § 1263.20(a) would provide that an institution approved for membership shall become a member upon the purchase of the amount of membership stock required under the Bank's capital plan. Paragraph (a) would further provide that any such institution must purchase the required stock within 60 days of the date of the Bank's approval, or that approval will become void. In such a case, the institution would need to re-apply for membership if it still wished to become a Bank member. This would carry over much of the substance of existing provisions that now appear, respectively, in paragraphs (a)(2) and (d) of existing § 1263.20.

Proposed § 1263.20(b) would provide that, after approving an institution for

[54] Pub. L. 106-102, 113 Stat. 1338 (Nov. 12, 1999).
[55] See 12 U.S.C. 1426.

membership and receiving payment in full for the par value of the Bank stock, a Bank shall issue to that institution the amount of capital stock required to be purchased under the Bank's capital plan. A similar provision appears in § 1263.21(a) of the existing regulation. Proposed § 1263.20(c) would carry over the substance of existing § 1263.20(e) by requiring that each Bank report to FHFA information regarding the minimum investment in Bank capital stock made by each new member under the regulation, in accordance with the instructions provided in FHFA's Data Reporting Manual.

Finally, the proposed rule would retain the substance of existing § 1263.22(b)(1), which requires each Bank to calculate annually each member's required minimum holdings for purposes of determining the number of votes that the member may cast in that year's election of directors and sets forth the procedures and timing that each Bank must follow with regard to that calculation. That material would be carried over with some minor textual edits to provide greater clarity, as the sole provision of proposed § 1263.22. Existing § 1263.23, which governs excess Bank stock, would be retained without change.

5. <u>Consolidations Involving Members—§ 1263.24</u>

Existing § 1263.24 governs the membership status of institutions that are the result of a recent business combination either of two or more Bank members or of a Bank member with a non-member. The proposed rule would retain nearly all of the existing text of that section without change, but would revise § 1263.24(b)(5), which addresses the approval of membership for a non-member institution that has absorbed a member of the Bank, to eliminate references to Banks that have not yet adopted a capital plan as required under the GLB Act. As proposed, that provision would provide that, if the application of such a consolidated institution is approved by a Bank, the consolidated institution shall become a member of that Bank upon the purchase of the amount of stock necessary, when combined with any Bank stock acquired from the disappearing member, to satisfy the minimum stock purchase requirements established by the Bank's capital plan. The proposed rule would also delete § 1263.24(d), which addresses approval of stock transfers from a disappearing member to a surviving member, because it implements a provision of the Bank Act that was repealed by the GLB Act.

6. <u>Withdrawal from membership—§§ 1263.26</u>

Section 1263.26 of the existing regulation governs voluntary withdrawal from Bank membership. Paragraph (d) of that section provides that no member may withdraw from membership unless FHFA certifies that the withdrawal will not cause the Bank system to fail to satisfy its statutory responsibility to fund the interest payments owed on obligations issued by the Resolution Funding Corporation (RefCorp).[56] As of July 2011, the Banks satisfied their obligation to contribute to the debt service on the RefCorp bonds, thereby rendering this provision moot. The proposed rule would therefore delete paragraph (d), but would leave the remainder of § 1263.26 unchanged.

7. <u>Termination of membership—§§ 1263.27-1263.28</u>

Section 1263.27 of the existing regulation establishes the grounds and procedures for the involuntary termination of an institution's Bank membership, as well as the rights of an institution whose membership is terminated. The proposed rule would retain that section without change.

---

[56] <u>See</u> 12 U.S.C. 1441b(f)(2)(C).

The proposed rule would add a new § 1263.28, which would specify the consequences of a member's failure to comply with the new ongoing membership eligibility requirements. Proposed § 1263.28(a) provides that any member that remains out of compliance with the "makes long-term home mortgage loans" requirement or, if applicable, the "10 percent" requirement, for two consecutive calendar years is ineligible to remain a member and must have its membership terminated.

Proposed § 1263.28(b) would establish a process by which a Bank must notify a member of its failure to comply with an eligibility requirement and provide an opportunity for the member to cure its noncompliance. If, when performing the annual calculations to determine its members' compliance with the "makes long-term home mortgage loans" and "10 percent" requirements, a Bank determines that a member does not comply with either one of those requirements, paragraph (b)(1) would require that the Bank notify the member in writing of that noncompliance, identify the applicable eligibility requirement, and provide the member with the data and calculations that demonstrate its noncompliance. The rule would also require the written notice to explain that the Bank will be required to terminate the institution's membership if it fails to satisfy the particular eligibility requirement for a second consecutive year and to inform the member of the actions it must take to return to compliance by the end of the then-current calendar year so as to prevent the termination of its membership.

Paragraph (b)(2) would require that the Bank keep itself and its non-compliant member abreast of the member's progress toward returning to compliance with the eligibility requirement by calculating the relevant asset ratio on a quarterly basis for the remainder of that year and informing the member of the Bank's assessment of the member's progress toward a return to compliance. Under these provisions, a member would have nearly one year within which to cure its noncompliance, i.e., the noncompliance would be identified as part of the Bank's annual compliance assessments and the member would have until the end of that calendar year to come into compliance with the eligibility requirements. Because the proposed rule would require the Banks to assess compliance only once per year, it is possible that the period of noncompliance actually could extend for nearly two years. For example, if the noncompliance is first detected based on a review of the calendar year-end regulatory financial report filed by a member, then it would be possible that the actual noncompliance could have occurred at any point during that calendar year.

Proposed § 1263.28(c) would require a Bank to terminate the membership of any member that had been notified of its failure to comply with one of the ongoing eligibility requirements as of the end of one year and that the Bank has determined remains out of compliance with that requirement as of the end of a second consecutive year. The rule would require the Bank to carry out the termination of membership as provided under § 1263.27, as it would be required to do for any termination of membership for failure to comply with a statutory or regulatory requirement, and to notify the member in writing that its membership has been terminated. FHFA has the authority under section 6(d)(2)(A) of the Bank Act, which sets forth the grounds upon which an institution's Bank membership may be involuntarily terminated, and as regulator of the Banks and administrator of the Bank Act, to adopt a regulation requiring a Bank to terminate the membership of an institution that has demonstrated its ongoing noncompliance with the statutory "makes long-term home mortgage loans" or "10 percent" eligibility requirements and the regulatory provisions implementing those requirements.

Section 6(d)(2)(A) of the Bank Act provides that the board of directors of a Bank "may terminate" the membership of any member institution if, "subject to the regulations of the Director" of FHFA, it determines that the member has either: (i) failed to comply with any provision of the Bank Act or FHFA regulations; or (ii) been determined to be insolvent, or otherwise subject to the appointment of a conservator, receiver, or other legal custodian, by a federal or state authority with regulatory and supervisory responsibility for the member.[57] The use of the word "may" indicates that Congress intended to permit a Bank a degree of discretion in deciding when it must terminate an institution's membership, but it does not vest in a Bank unlimited discretion to decide when to exercise that authority, as is evidenced by the accompanying language that a Bank's termination authority is "subject to regulations of the Director." That reservation of authority to the Director of FHFA, as well as accepted rules of statutory construction,[58] allow FHFA to adopt a regulation that specifies the circumstances in which an ongoing violation of the law requires a Bank to exercise its termination authority, which is what the proposed regulation would do. This is appropriate where, as here, the regulatory violation is not of just any provision of the Bank Act or FHFA regulations, but of the very regulation that defines eligibility for membership, the purpose of which would be

[57] 12 U.S.C. 1426(d)(2)(A).

[58] As the Court of Appeals for the D.C. Circuit has explained, "'May' ordinarily connotes discretion, but neither in lay nor legal understanding is the result inexorable. Rather, the conclusion to be reached 'depends on the context of the statute, and on whether it is fairly to be presumed that it was the intention of the legislature to confer a discretionary power or to impose an imperative duty.'" Thompson v. Clifford, 408 F.2d 154, 158 (D.C. Cir. 1968) (citations omitted); see also Halverson v. Slater, 129 F.3d 180, 188-189 (D.C. Cir. 1997).

defeated if membership were allowed to continue.

By allowing for a one-year period within which to cure a violation of these eligibility requirements, the proposed rule recognizes that Congress did not mandate an immediate termination of membership for any violation of the Bank Act or FHFA regulations. The proposed rule contemplates that during that cure period the Banks would work with any noncompliant members to come back into compliance with those requirements. By requiring the Banks to terminate the membership of any institution that has failed, for over a year and after being notified of its noncompliance, to come back into compliance with the eligibility requirements, the proposed rule also recognizes the authority and responsibility of FHFA to take whatever actions are necessary to ensure that the purposes and provisions of the Bank Act are carried out. By setting the boundaries of a Bank's discretion in this fashion, FHFA is giving effect to and acting consistently with the specific provisions of section 6(d)(2)(A) and its general supervisory authorities.

8. <u>Remaining provisions—§§ 1263.29-1263.32</u>

The proposed rule would retain the remaining provisions of the existing membership regulation without change, with the exception that the cross-reference to § 1263.22(b)(1) found in § 1263.31(d) (which requires each member to provide its Bank annually with the data necessary to calculate its minimum required holdings of Bank stock) would be revised to reflect its redesignation under the proposed rule as § 1263.22.

IV. Consideration of Differences Between the Banks and the Enterprises

Section 1313(f) of the Safety and Soundness Act requires the Director of FHFA, when promulgating regulations relating to the Banks, to consider the differences between the Banks and the Enterprises (Fannie Mae and Freddie Mac) as they relate to: the Banks' cooperative ownership structure; the mission of providing liquidity to members; the affordable housing and community development mission; their capital structure; and their joint and several liability on consolidated obligations.[59] The Director also may consider any other differences that are deemed appropriate. In preparing this proposed rule, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors, and determined that the rule is appropriate. FHFA requests comments regarding whether differences related to those factors should result in any revisions to the proposed rule.

V. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) requires that FHFA consider the impact of paperwork and other information collection burdens imposed on the public.[60] Under the PRA and the implementing regulations of the Office of Management and Budget (OMB), an agency may not collect or sponsor the collection of information, nor may it impose an information collection requirement unless it displays a currently valid control number assigned by OMB.[61] FHFA's regulation "Members of the Federal Home Loan Banks," located at 12 CFR part 1263, contains several collections of information that OMB has approved under control number 2590-0003, which is due to expire on December 31, 2016. This proposed rule would add a new information collection requirement, which is described below. As required by the PRA, FHFA has submitted an analysis of the proposed collection of information contained in this proposed rule to

[59] 12 U.S.C. 4513(f).
[60] See 44 U.S.C. 3507(a) and (d).
[61] See 44 U.S.C. 3512(a); 5 CFR 1320.8(b)(3)(vi).

OMB for review.[62]

Summary: Existing part 1263 contains four different types of submissions by Bank members or by institutions wishing to become a Bank member: (I) applications for membership and supporting materials; (II) notices of appeal to FHFA by institutions that have been denied membership by a Bank; (III) requests to withdraw from Bank membership; and (IV) applications for transfer of membership to a different Bank and supporting materials.

This proposed rule would add a fifth information collection requirement to part 1263, but would not alter any of the four existing requirements. As described in section III of the Supplementary Information above, § 1263.11(a)(2) of the proposed rule would require each Bank to determine annually whether each of its members maintains at least one percent of its total assets in home mortgage loans, as would be required by proposed § 1263.9(b). Proposed § 1263.11(a)(2) would also require each Bank to determine annually whether each of its members that is subject to the "10 percent" requirement maintains at least 10 percent of its assets in residential mortgage loans, as would be required by proposed § 1263.10(b). Proposed § 1263.11(a)(1) would provide that a Bank must determine whether an applicant maintains those minimum asset ratios at the time it considers that institution's application for Bank membership.

Under the proposed rule, the Banks would in most cases acquire the data necessary to make those determinations from each institution's year-end regulatory financial reports or audited financial statements. In most cases where the data contained in an institution's regulatory financial report or audited financial statements is insufficient

[62] See 44 U.S.C. 3507(d).

to demonstrate that it complies with the applicable asset ratio requirements, proposed § 1263.11(b)(1)(ii) would require the institution (if it wished to become or remain a Bank member) to obtain from its external auditor and provide to the Bank a written certification stating the actual amount of the relevant assets held by the institution on the appropriate dates. Where the institution in question is a CDFI with less than $100 million in assets, proposed § 1263.11(b)(2)(iii) would permit it to provide a written certification from an executive officer instead.

Use: Each Bank would use the information collected under proposed part 1263 to: (a) determine whether an institution satisfies the statutory and regulatory requirements for Bank membership; (b) process member withdrawals; and (c) process member transfers to a different Bank district. When appropriate, FHFA may use the information collection to determine whether an institution that has been denied membership by a Bank should be permitted to become a member of that Bank.

Respondents: Respondents would be institutions that are Bank members or that are applying for Bank membership.

Annual Burden Estimates: FHFA has analyzed the cost and hour burden for the five facets of the information collection: (1) membership application process; (2) appeal of membership denial; (3) membership withdrawals; (4) transfer of membership to another Bank district; and (5) certifications regarding compliance with asset ratio requirements. The estimate for the total annual hour burden for all respondents is 3,335 hours. The estimate for the total annual cost burden is $244,548. These estimates are based on the following calculations:

1. Membership Application

FHFA estimates the total annual average number of applicants at 157, with 1 response per applicant. The estimate for the average hours per application is 11.7 hours. The estimate for the annual hour burden for applicants is 1,837 hours (157 applicants x 1 response per applicant x 11.7 hours per response). The estimate for the total annual cost burden to applicants for the membership application process is $135,365.

2. <u>Appeal of Membership Denials</u>

FHFA estimates the total annual average number of appellants at 1, with 1 response per appellant. The estimate for the average hours per application for appeal is 10 hours. The estimate for the annual hour burden for appellants is 10 hours (10 appellants x 1 response per appellant x 10 hours per response). The estimate for the total annual cost burden to applicants for the appeal of membership denial process is $950.

3. <u>Withdrawals From Membership</u>

FHFA estimates the total annual average number of membership withdrawals at 275, with 1 response per applicant. The estimate for the average hours per application is 1.5 hours. The estimate for the annual hour burden for applicants is 413 hours (275 withdrawals x 1 response per applicant x 1.5 hours per response). The estimate for the total annual cost burden to members for withdrawals from membership is $39,188.

4. <u>Transfer of Membership</u>

FHFA estimates the total annual average number of membership transfer requests at 1, with 1 response per applicant. The estimate for the average hours per application is 1.5 hours. The estimate for the annual hour burden for applicants is 1.5 hours (1 transfer x 1 response per applicant x 1.5 hours per response). The estimate for the total annual cost burden to member respondents of the transfer of membership process is $110.

5. Certifications Regarding Compliance With Asset Ratio Requirements

FHFA estimates the total annual hour burden for members and applicants arising from the asset ratio requirements to be 1,073 hours and the total annual cost burden to be $68,935, calculated as set forth below.

FHFA estimates the total annual average number of Bank members and applicants that would keep records to track the asset categories needed to prepare the asset ratio certifications at 330. The estimate for the average annual recordkeeping hours for each member or applicant, including a one-time initial modification of the institution's accounting information system, is 3 hours. The estimate for the annual hour burden for all members and applicants arising from this recordkeeping is 990 hours (330 members or applicants x 3 hours). The estimate for the total annual cost burden to members and applicants of this recordkeeping is $61,050.

FHFA estimates the total annual average number of Bank members and applicants that would submit asset ratio certifications at 165, with 1 submission per institution. The estimate for the average hours per submission is 0.5 hours. The estimate for the annual hour burden for all members and applicants arising from this submission is 83 hours (165 members or applicants x 0.5 hours). The estimate for the total annual cost burden to members and applicants of this submission is $7,885.

Comment Request: FHFA will accept written comments concerning the accuracy of the burden estimates and suggestions for reducing the burden at the address listed above. Comments may also be submitted to the Office of Information and Regulatory Affairs, OMB, Attention: Desk Officer for Federal Housing Finance Agency, Room

10102, New Executive Office Building, 725 17th Street, NW., Washington, DC 20503; Fax: (202) 395-6974; or Email: OIRA_Submission@omb.eop.gov.

Written comments are requested on: (1) Whether the proposed collection of information is necessary for the proper performance of FHFA functions, including whether the information has practical utility; (2) the accuracy of FHFA estimates of the burdens of the collection of information; (3) ways to enhance the quality, utility, and clarity of the information collected; and (4) ways to minimize the burden of the proposed collection of information on respondents, including through the use of automated collection techniques or other forms of information technology.

Individuals and organizations may send comments on the proposed information collection requirement by [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

VI. Regulatory Flexibility Act

The Regulatory Flexibility Act[63] (RFA) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities.[64] FHFA has considered the impact of the proposed rule under the RFA. The General Counsel of FHFA certifies that the proposed rule, if adopted as a final rule, is not likely to have a significant economic impact on a substantial

[63] 5 U.S.C. 601, et seq.
[64] See 5 U.S.C. 605(b).

number of small entities because the regulation applies only to the Banks, which are not small entities for purposes of the RFA.

List of Subjects

12 CFR Part 1263

Federal home loan banks, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons stated in the **SUPPLEMENTARY INFORMATION**, and under the authority of 12 U.S.C. 4526, FHFA proposes to amend part 1263 of subchapter D of chapter XII of title 12 of the Code of Federal Regulations as follows:

1. Revise part 1263 to read as follows:

PART 1263—MEMBERS OF THE BANKS

Subpart A—Definitions

Subpart B—Membership Application Process

Subpart C—Eligibility Requirements

Authority: 12 U.S.C. 1422, 1423, 1424, 1426, 1430, 1442, 4511, 4513.

Subpart A—Definitions

§ 1263.1 Definitions.

For purposes of this part:

Adjusted net income means net income, excluding extraordinary items such as income received from, or expense incurred in, sales of securities or fixed assets, reported on a regulatory financial report.

Aggregate unpaid loan principal means the aggregate unpaid principal of a subscriber's or member's home mortgage loans, home-purchase contracts and similar obligations.

Allowance for loan and lease losses means a specified balance-sheet account held to fund potential losses on loans or leases, which is reported on a regulatory financial report.

Appropriate regulator means:

(1) In the case of an insured depository institution or a CDFI credit union, an appropriate Federal banking agency or appropriate State regulator, as applicable; or

(2) In the case of an insurance company, an appropriate State regulator accredited by the NAIC.

Captive means a company that is authorized under state law to conduct an insurance business, but that does not meet the definition of "insurance company" set forth in this section or fall within any other category of institution eligible for membership.

CDFI credit union means a state-chartered credit union that has been certified as a CDFI by the CDFI Fund and that does not have federal share insurance.

CDFI Fund means the Community Development Financial Institutions Fund established under section 104(a) of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4703(a)).

CFI asset cap means $1 billion, as adjusted annually by FHFA, beginning in 2009, to reflect any percentage increase in the preceding year's Consumer Price Index (CPI) for all urban consumers, as published by the U.S. Department of Labor.

Class A stock means capital stock issued by a Bank, including subclasses, that has the characteristics specified in section 6(a)(4)(A)(i) of the Bank Act (12 U.S.C. 1426(a)(4)(A)(i)) and applicable FHFA regulations.

Class B stock means capital stock issued by a Bank, including subclasses, that has the characteristics specified in section 6(a)(4)(A)(ii) of the Bank Act (12 U.S.C. 1426(a)(4)(A)(ii)) and applicable FHFA regulations.

Combination business or farm property means real property for which the total appraised value is attributable to residential, and business or farm uses.

Community development financial institution or CDFI means an institution that is certified as a community development financial institution by the CDFI Fund under the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4701 et seq.), other than a bank or savings association insured under the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.), a holding company for such a bank or savings association, or a credit union insured under the Federal Credit Union Act (12 U.S.C. 1751 et seq.).

Community financial institution or CFI means an institution:

(1) The deposits of which are insured under the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.); and

(2) The total assets of which, as of the date of a particular transaction, are less than the CFI asset cap, with total assets being calculated as an average of total assets over three years, with such average being based on the institution's regulatory financial reports filed with its appropriate regulator for the most recent calendar quarter and the immediately preceding 11 calendar quarters.

Composite regulatory examination rating means a composite rating assigned to an institution following the guidelines of the Uniform Financial Institutions Rating System (issued by the Federal Financial Institutions Examination Council), including a CAMELS rating or other similar rating, contained in a written regulatory examination report.

Consolidation includes a consolidation, a merger, or a purchase of substantially all of the assets and assumption of substantially all of the liabilities of an entity by another entity.

CRA means the Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.).

CRA performance evaluation means, unless otherwise specified, a formal performance evaluation of an institution prepared by its appropriate regulator as required by the CRA or, if such a formal evaluation is unavailable for a particular institution, an informal or preliminary evaluation.

De novo insured depository institution means an insured depository institution the charter of which was approved by its appropriate regulator within the three years prior to the date that the institution applies for Bank membership.

Dwelling unit means a single room or a unified combination of rooms designed for residential use.

Enforcement action means any written notice, directive, order, or agreement initiated by an applicant for Bank membership or by its appropriate regulator to address any operational, financial, managerial or other deficiencies of the applicant identified by such regulator. An "enforcement action" does not include a board of directors' resolution adopted by the applicant in response to examination weaknesses identified by such regulator.

Funded residential construction loan means the portion of a loan secured by real property made to finance the on-site construction of dwelling units on one-to-four family property or multifamily property disbursed to the borrower.

Gross revenues means, in the case of a CDFI applicant, total revenues received from all sources, including grants and other donor contributions and earnings from operations.

Home mortgage loan means:

(1) A loan, whether or not fully amortizing, or an interest in such a loan, which is secured by a mortgage, deed of trust, or other security agreement that creates a first lien on one of the following interests in property:

(i) One-to-four family property or multifamily property, in fee simple;

(ii) A leasehold on one-to-four family property or multifamily property under a lease of not less than 99 years that is renewable, or under a lease having a period of not less than 50 years to run from the date the mortgage was executed; or

(iii) Combination business or farm property where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property, or in the case of any community financial institution, combination business or farm property, on which is located a permanent structure actually used as a residence (other than for temporary or seasonal housing), where the residence constitutes an integral part of the property; or

(2) A security representing:

(i) A right to receive a portion of the cash flows from a pool of long-term loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of paragraph (1) of this definition; or

(ii) An interest in other securities, all of which meet the requirements of paragraph (2)(i) of this definition.

Insurance company means a company whose primary business is the underwriting of insurance for nonaffiliated persons or entities.

Insured depository institution means an insured depository institution as defined in section 2(9) of the Bank Act, as amended (12 U.S.C. 1422(9)).

Long-term means a term to maturity of five years or greater at the time of origination.

Manufactured housing means a manufactured home as defined in section 603(6) of the National Manufactured Housing Construction and Safety Standards Act of 1974, as amended (42 U.S.C. 5402(6)).

Multifamily property means:

(1) Real property that is solely residential and includes five or more dwelling units;

(2) Real property that includes five or more dwelling units combined with commercial units, provided that the property is primarily residential; or

(3) Nursing homes, dormitories, or homes for the elderly.

NAIC means the National Association of Insurance Commissioners.

Nonperforming loans and leases means the sum of the following, reported on a regulatory financial report:

(1) Loans and leases that have been past due for 90 days (60 days, in the case of credit union applicants) or longer but are still accruing;

(2) Loans and leases on a nonaccrual basis; and

(3) Restructured loans and leases (not already reported as nonperforming).

Nonresidential real property means real property that is not used for residential purposes, including business or industrial property, hotels, motels, churches, hospitals, educational and charitable institution buildings or facilities, clubs, lodges, association buildings, golf courses, recreational facilities, farm property not containing a dwelling unit, or similar types of property.

One-to-four family property means:

(1) Real property that is solely residential, including one-to-four family dwelling units or more than four family dwelling units if each dwelling unit is separated from the other dwelling units by dividing walls that extend from ground to roof, such as row houses, townhouses or similar types of property;

(2) Manufactured housing if applicable state law defines the purchase or holding of manufactured housing as the purchase or holding of real property;

(3) Individual condominium dwelling units or interests in individual cooperative housing dwelling units that are part of a condominium or cooperative building without regard to the number of total dwelling units therein; or

(4) Real property which includes one-to-four family dwelling units combined with commercial units, provided the property is primarily residential.

Operating expenses means, in the case of a CDFI applicant, expenses for business operations, including, but not limited to, staff salaries and benefits, professional fees, interest, loan loss provision, and depreciation, contained in the applicant's audited financial statements.

Other real estate owned means all other real estate owned (i.e., foreclosed and repossessed real estate), reported on a regulatory financial report, and does not include direct and indirect investments in real estate ventures.

Regulatory examination report means a written report of examination prepared by the applicant's appropriate regulator, containing, in the case of insured depository institution applicants, a composite rating assigned to the institution following the guidelines of the Uniform Financial Institutions Rating System, including a CAMELS rating or other similar rating.

Regulatory financial report means a financial report that an institution is required to file with its appropriate regulator on a specific periodic basis, including the quarterly call report for commercial banks and savings associations, quarterly or semi-annual call report for credit unions, NAIC's annual or quarterly statement for insurance companies, or other similar report, including such report maintained by the appropriate regulator in an electronic database.

Residential mortgage loan means any one of the following types of loans, whether or not fully amortizing:

(1) A home mortgage loan;

(2) A funded residential construction loan;

(3) A loan secured by manufactured housing whether or not defined by state law as secured by an interest in real property;

(4) A loan secured by a junior lien on one-to-four family property or multifamily property;

(5) A security representing:

(i) A right to receive a portion of the cash flows from a pool of loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of one of paragraphs (1) through (4) of this definition; or

(ii) An interest in other securities, all of which meet the requirements of paragraph (5)(i) of this definition;

(6) A home mortgage loan secured by a leasehold interest, as defined in paragraph (1)(ii) of the definition of "home mortgage loan," except that the period of the lease term may be for any duration; or

(7) A loan that finances one or more properties or activities that, if made by a member, would satisfy the statutory requirements for the Community Investment Program established under section 10(i) of the Bank Act (12 U.S.C. 1430(i)), or the regulatory requirements established for any Community Investment Cash Advance program.

Restricted assets means both permanently restricted assets and temporarily restricted assets, as those terms are used in Financial Accounting Standard No. 117, or any successor publication.

Total assets means the total assets reported on a regulatory financial report or, in the case of a CDFI, the total assets contained in the CDFI's audited financial statements.

Unrestricted cash and cash equivalents means, in the case of a CDFI applicant, cash and highly liquid assets that can be easily converted into cash that are not restricted in a manner that prevents their use in paying expenses, as contained in the applicant's audited financial statements.

Subpart B—Membership Application Process

§ 1263.2 Membership application requirements.

(a) Application. Except as otherwise specified in this part, no institution may become a member of a Bank unless it has submitted to that Bank an application that satisfies the requirements of this part. The application shall include a written resolution or certification duly adopted by the applicant's board of directors, or by an individual with authority to act on behalf of the applicant's board of directors, of the following:

(1) Applicant review. Applicant has reviewed the requirements of this part and, as required by this part, has provided to the best of applicant's knowledge the most recent, accurate, and complete information available; and

(2) Duty to supplement. Applicant will promptly supplement the application with any relevant information that comes to applicant's attention prior to the Bank's decision on whether to approve or deny the application, and if the Bank's decision is appealed pursuant to § 1263.5, prior to resolution of any appeal by FHFA.

(b) Digest. The Bank shall prepare a written digest for each applicant stating whether or not the applicant meets each of the requirements in §§ 1263.6 to 1263.19, the Bank's findings, and the reasons therefor.

(c) File. The Bank shall maintain a membership file for each applicant for at least three years after the Bank decides whether to approve or deny membership or, in the case of an appeal to FHFA, for three years after the resolution of the appeal. The membership file shall contain at a minimum:

(1) Digest. The digest required by paragraph (b) of this section.

(2) Required documents. All documents required to be filed by an applicant under §§ 1263.6 to 1263.19, including those documents required to establish or rebut a

presumption under this part, shall be described in and attached to the digest. The Bank may retain in the file only the relevant portions of the regulatory financial reports required by this part. If an applicant's appropriate regulator requires return or destruction of a regulatory examination report, the date that the report is returned or destroyed shall be noted in the file.

(3) Additional documents. Any additional document submitted by the applicant, or otherwise obtained or generated by the Bank, concerning the applicant.

(4) Decision resolution. The decision resolution described in § 1263.3(b).

§ 1263.3 Decision on application.

(a) Authority. FHFA hereby authorizes the Banks to approve or deny all applications for membership, subject to the requirements of this part. The authority to approve membership applications may be exercised only by a committee of the Bank's board of directors, the Bank president, or a senior officer who reports directly to the Bank president, other than an officer with responsibility for business development.

(b) Decision resolution. For each applicant, the Bank shall prepare a written resolution duly adopted by the Bank's board of directors, by a committee of the board of directors, or by an officer with delegated authority to approve membership applications. The decision resolution shall state:

(1) That the statements in the digest are accurate to the best of the Bank's knowledge, and are based on a diligent and comprehensive review of all available information identified in the digest; and

(2) The Bank's decision and the reasons therefor. Decisions to approve an application should state specifically that:

(i) The applicant is authorized under the laws of the United States and the laws of the appropriate state to become a member of, purchase stock in, do business with, and maintain deposits in, the Bank to which the applicant has applied; and

(ii) The applicant meets all of the membership eligibility criteria of the Bank Act and this part.

(c) Action on applications. The Bank shall act on an application within 60 calendar days of the date the Bank deems the application to be complete. An application is “complete” when a Bank has obtained all the information required by this part, and any other information the Bank deems necessary, to process the application. If an application that was deemed complete subsequently is deemed incomplete because the Bank determines during the review process that additional information is necessary to process the application, the Bank may suspend the 60-day processing period until the Bank again deems the application to be complete, at which time the processing period shall resume. The Bank shall notify an applicant in writing when it deems the applicant’s application to be complete, and shall maintain a copy of the notice in the applicant’s membership file. The Bank shall notify an applicant whenever it suspends or resumes the 60-day processing period and shall maintain a written record of those notifications in the applicant’s membership file. Within three business days of a Bank’s decision on an application, the Bank shall provide the applicant and FHFA with a copy of the Bank’s decision resolution.

§ 1263.4 Automatic membership.

(a) Automatic membership for certain charter conversions. An insured depository institution member that converts from one charter type to another automatically shall become a member of the Bank of which the converting institution was a member on the effective date of the conversion, provided that the converted institution continues to be an insured depository institution and the assets of the institution immediately before and immediately after the conversion are not materially different. In such case, all relationships existing between the member and the Bank at the time of such conversion may continue.

(b) Automatic membership for transfers. Any member that relocates its principal place of business to another Bank district or that redesignates its principal place of business to another Bank district pursuant to § 1263.19(c) automatically shall become a member of the Bank of that district upon the purchase of the minimum amount of Bank stock required for membership in that Bank, as required by § 1263.20.

(c) Automatic membership, in the Bank's discretion, for certain consolidations.—(1) If a member institution (or institutions) and a nonmember institution are consolidated, and the consolidated institution has its principal place of business in a State in the same Bank district as the disappearing institution (or institutions), and the consolidated institution will operate under the charter of the nonmember institution, on the effective date of the consolidation, the consolidated institution may, in the discretion of the Bank of which the disappearing institution (or institutions) was a member immediately prior to the effective date of the consolidation, automatically become a member of such Bank upon the purchase of the minimum amount of Bank stock required for membership in that Bank, as required by § 1263.20, provided that:

(i) 90 percent or more of the consolidated institution’s total assets are derived from the total assets of the disappearing member institution (or institutions); and

(ii) The consolidated institution provides written notice to such Bank, within 60 calendar days after the effective date of the consolidation, that it desires to be a member of the Bank.

(2) The provisions of § 1263.24(b)(4)(i) shall apply, and upon approval of automatic membership by the Bank, the provisions of § 1263.24(c) shall apply.

§ 1263.5 Appeals.

(a) Appeals by applicants.—(1) Filing procedure. Within 90 calendar days of the date of a Bank's decision to deny an application for membership, the applicant may file a written appeal of the decision with FHFA.

(2) Documents. The applicant's appeal shall be addressed to the Deputy Director for Federal Home Loan Bank Regulation, Federal Housing Finance Agency, 400 Seventh Street, SW., Washington, DC 20024, with a copy to the Bank, and shall include the following documents:

(i) Bank's decision resolution. A copy of the Bank's decision resolution; and

(ii) Basis for appeal. An applicant must provide a statement of the basis for the appeal with sufficient facts, information, analysis, and explanation to rebut any applicable presumptions, or otherwise to support the applicant's position.

(b) Record for appeal.—(1) Copy of membership file. Upon receiving a copy of an appeal, the Bank whose action has been appealed (appellee Bank) shall provide FHFA with a copy of the applicant's complete membership file. Until FHFA resolves the appeal, the appellee Bank shall supplement the materials provided to FHFA as any new materials are received.

(2) Additional information. FHFA may request additional information or further

supporting arguments from the appellant, the appellee Bank, or any other party that FHFA deems appropriate.

(c) Deciding appeals. FHFA shall consider the record for appeal described in paragraph (b) of this section and shall resolve the appeal based on the requirements of the Bank Act and this part within 90 calendar days of the date the appeal is filed with FHFA. In deciding the appeal, FHFA shall apply the presumptions in this part, unless the appellant or appellee Bank presents evidence to rebut a presumption as provided in § 1263.18.

Subpart C—Eligibility Requirements

§ 1263.6 General eligibility requirements.

(a) Requirements. Any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, community development financial institution (including a CDFI credit union), or insured depository institution shall be eligible to be a member of a Bank if:

(1) It is duly organized under tribal law, or under the laws of any State or of the United States;

(2) It is subject to inspection and regulation under the banking laws, or under similar laws, of any State or of the United States or, in the case of a CDFI, is certified by the CDFI Fund;

(3) It makes long-term home mortgage loans;

(4) Its financial condition is such that advances may be safely made to it;

(5) The character of its management is consistent with sound and economical home financing; and

(6) Its home financing policy is consistent with sound and economical home financing.

(b) Additional eligibility requirement for certain insured depository institutions. In order to be eligible to be a member of a Bank, an insured depository institution that is not a community financial institution and that was not a member of a Bank as of January 1, 1989 also must have at least 10 percent of its total assets in residential mortgage loans.

(c) Ineligibility.—(1) General. Except as provided in paragraph (c)(2) of this section, an institution that does not satisfy the requirements of this part shall be ineligible to be a member of a Bank.

(2) Temporary exception for certain members.—(i) Any captive that was admitted to Bank membership prior to [INSERT DATE OF PUBLICATION OF THE PROPOSED RULE IN THE FEDERAL REGISTER] may remain a member of its Bank until [DATE FIVE (5) YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE] notwithstanding its failure to meet the definition of "insurance company" in § 1263.1, provided that a Bank may not make or renew any advance to such a member:

(A) If after doing so the total outstanding advances to that member would exceed forty (40) percent of the member's total assets; or

(B) If the new or renewed advance has a maturity date later than [DATE FIVE (5) YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE];

(ii) A Bank shall terminate the membership of any captive that has remained a Bank member pursuant to paragraph (c)(2)(i) of this section as of [DATE FIVE (5) YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE], as provided under § 1263.27.

§ 1263.7 Duly organized requirement.

An institution shall be deemed to be duly organized, as required by section 4(a)(1)(A) of the Bank Act (12 U.S.C. 1424(a)(1)(A)) and § 1263.6(a)(1), if it is chartered by a State or federal agency as a building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, or insured depository institution or, in the case of a CDFI, is incorporated under State or tribal law.

§ 1263.8 Subject to inspection and regulation requirement.

An institution shall be deemed to be subject to inspection and regulation, as required by section 4(a)(1)(B) of the Bank Act (12 U.S.C. 1424 (a)(1)(B)) and § 1263.6(a)(2) if, in the case of an insured depository institution or insurance company, it is subject to inspection and regulation by its appropriate regulator. A CDFI that is certified by the CDFI Fund is not subject to this requirement.

§ 1263.9 Makes long-term home mortgage loans requirement.

(a) Continuous one percent requirement. An institution shall be deemed to make long-term home mortgage loans, as required by section 4(a)(1)(C) of the Bank Act (12 U.S.C. 1424(a)(1)(C)) and § 1263.6(a)(3), if it maintains at least one percent of its total assets in long-term home mortgage loans. This requirement shall apply on a continuous basis to all members.

(b) Determining compliance.—(1) In determining whether an institution maintains at least one percent of its total assets in long-term home mortgage loans as required under paragraph (a) of this section, a Bank shall use three-year averages for both the numerator (the amount of the institution's home mortgage loans) and the denominator (the amount of the institution's total assets), with all numbers being determined as of the end of each of the preceding three calendar years.

(2) A Bank shall perform the calculation required under paragraph (b)(1) of this section in conformity with the standards set forth in § 1263.11.

§ 1263.10 Ten percent requirement for certain insured depository institution applicants.

(a) Continuous ten percent requirement. An insured depository institution applicant that is subject to the 10 percent requirement of section 4(a)(2)(A) of the Bank Act (12 U.S.C. 1424(a)(2)(A)) and § 1263.6(b) shall be deemed to comply with that requirement if it maintains at least 10 percent of its total assets in residential mortgage loans. This requirement shall apply on a continuous basis to all insured depository institution members that are not community financial institutions and were not members of a Bank as of January 1, 1989.

(b) Determining compliance.—(1) In determining whether an institution maintains at least 10 percent of its total assets in residential mortgage loans as required under paragraph (a) of this section, a Bank shall use three-year averages for both the numerator (the amount of the institution's residential mortgage loans) and the denominator (the amount of the institution's total assets), with all numbers being determined as of the end of each of the preceding three calendar years. For purposes of this calculation, any assets used to secure mortgage-backed securities as described in paragraph (5) of the definition of "residential mortgage loan" set forth in § 1263.1 shall not be included in the amount of residential mortgage loans held.

(2) Each Bank shall perform the calculation required under paragraph (b)(1) of

this section in conformity with the standards set forth in § 1263.11.

§ 1263.11 Timing of and standards for calculations required under §§ 1263.9 and 1263.10.

(a) Timing of calculations.—(1) Applicants. For applicants, a Bank shall perform the calculations required under § 1263.9(b) and, if applicable, § 1263.10(b) at the time it is considering the institution's application to become a member of the Bank.

(2) Members. For members, a Bank shall perform the calculations required under § 1263.9(b) and, if applicable, § 1263.10(b) annually, as soon as practicable after the member's regulatory financial report or, where appropriate, audited financial statements for the preceding year-end becomes available.

(b) Sources of Data.—(1) Insured depository institutions and insurance companies. For insured depository institutions and insurance companies:

(i) A Bank shall obtain the data necessary to perform the calculations required under §§ 1263.9(b) and 1263.10(b) from the three most recently available year-end regulatory financial reports filed by the institution with its appropriate regulator.

(ii) If the data obtained from the regulatory financial reports for a particular institution do not demonstrate that it meets the one percent requirement of § 1263.9(a) or, if applicable, the 10 percent requirement of § 1263.10(a), then a Bank may accept a written certification from the institution's external auditor that states the actual amount of home mortgage loans or residential mortgage loans, as appropriate, held by the institution as of the end of any or all of the three most recently completed calendar years and may use that data in performing the required calculation for that institution.

(2) CDFIs. For CDFIs, other than CDFI credit unions:

(i) A Bank shall obtain the data necessary to perform the calculation required under § 1263.9 from the institution's annual audited financial statements.

(ii) If the audited financial statements do not demonstrate that the CDFI meets the one percent requirement of § 1263.9(a), then a Bank may accept a written certification from the CDFI's external auditor that states the actual amount of total assets and home mortgage loans held by the CDFI as of the end of each of the three most recently completed calendar years, and may use that data in performing the required calculation for that CDFI.

(iii) For any CDFI with average total assets of less than $100 million over the three preceding year-ends, a Bank may use a written certification prepared by an executive officer of the CDFI, in lieu of a certification from the external auditor.

(c) Agency guidance. In determining the amount of an institution's home mortgage loans for purposes of the calculation required under § 1263.9, or the amount of an institution's residential mortgage loans for purposes of the calculation required under § 1263.10, a Bank shall follow any guidance issued by FHFA regarding the derivation of data from particular types of regulatory financial reports, including the extent to which particular schedules or line items may be used to determine the amount of an institution's home mortgage loans or residential mortgage loans.

§ 1263.12 Financial condition requirement for depository institutions and CDFI credit unions.

(a) Review requirement. In determining whether a building and loan association, savings and loan association, cooperative bank, homestead association, savings bank, insured depository institution, or CDFI credit union has complied with the financial condition requirements of section 4(a)(2)(B) of the Bank Act (12 U.S.C. 1424(a)(2)(B)) and § 1263.6(a)(4), the Bank shall obtain as a part of the membership application and review each of the following documents:

(1) Regulatory financial reports. The regulatory financial reports filed by the applicant with its appropriate regulator for the last six calendar quarters and three year-ends preceding the date the Bank receives the application;

(2) Financial statement. In order of preference—

(i) The most recent independent audit of the applicant conducted in accordance with generally accepted auditing standards by a certified public accounting firm which submits a report on the applicant;

(ii) The most recent independent audit of the applicant's parent holding company conducted in accordance with generally accepted auditing standards by a certified public accounting firm which submits a report on the consolidated holding company but not on the applicant separately;

(iii) The most recent directors' examination of the applicant conducted in accordance with generally accepted auditing standards by a certified public accounting firm;

(iv) The most recent directors' examination of the applicant performed by other external auditors;

(v) The most recent review of the applicant's financial statements by external auditors;

(vi) The most recent compilation of the applicant's financial statements by external auditors; or

(vii) The most recent audit of other procedures of the applicant.

(3) Regulatory examination report. The applicant's most recent available regulatory examination report prepared by its appropriate regulator, a summary prepared by the Bank of the applicant's strengths and weaknesses as cited in the regulatory examination report, and a summary prepared by the Bank or applicant of actions taken by the applicant to respond to examination weaknesses;

(4) Enforcement actions. A description prepared by the Bank or applicant of any outstanding enforcement actions against the applicant, responses by the applicant, reports as required by the enforcement action, and verbal or written indications, if available, from the appropriate regulator of how the applicant is complying with the terms of the enforcement action; and

(5) Additional information. Any other relevant document or information concerning the applicant that comes to the Bank's attention in reviewing the applicant's financial condition.

(b) Standards. An applicant of the type described in paragraph (a) of this section shall be deemed to be in compliance with the financial condition requirement of section 4(a)(2)(B) of the Bank Act (12 U.S.C. 1424(a)(2)(B)) and § 1263.6(a)(4), if:

(1) Recent composite regulatory examination rating. The applicant has received a composite regulatory examination rating from its appropriate regulator within two years preceding the date the Bank receives the application;

(2) Capital requirement. The applicant meets all of its minimum statutory and regulatory capital requirements as reported in its most recent quarter-end regulatory financial report filed with its appropriate regulator; and

(3) Minimum performance standard—(i) Except as provided in paragraph (b)(3)(iii) of this section, the applicant's most recent composite regulatory examination rating from its appropriate regulator within the past two years was "1", or the most recent rating was "2" or "3" and, based on the applicant's most recent regulatory financial report filed with its appropriate regulator, the applicant satisfied all of the following performance trend criteria—

(A) Earnings. The applicant's adjusted net income was positive in four of the six most recent calendar quarters;

(B) Nonperforming assets. The applicant's nonperforming loans and leases plus other real estate owned, did not exceed 10 percent of its total loans and leases plus other real estate owned, in the most recent calendar quarter; and

(C) Allowance for loan and lease losses. The applicant's ratio of its allowance for loan and lease losses plus the allocated transfer risk reserve to nonperforming loans and leases was 60 percent or greater during four of the six most recent calendar quarters.

(ii) For applicants that are not required to report financial data to their appropriate regulator on a quarterly basis, the information required in paragraph (b)(3)(i) of this section may be reported on a semi-annual basis.

(iii) A CDFI credit union applicant must meet the performance trend criteria in paragraph (b)(3)(i) of this section irrespective of its composite regulatory examination rating.

(c) Eligible collateral not considered. The availability of sufficient eligible collateral to secure advances to the applicant is presumed and shall not be considered in determining whether an applicant is in the financial condition required by section

4(a)(2)(B) of the Bank Act (12 U.S.C. 1424(a)(2)(B)) and § 1263.6(a)(4).

§ 1263.13 Character of management requirement.

(a) General. A building and loan association, savings and loan association, cooperative bank, homestead association, savings bank, insured depository institution, insurance company, and CDFI credit union shall be deemed to be in compliance with the character of management requirements of section 4(a)(2)(C) of the Bank Act (12 U.S.C. 1424(a)(2)(C)) and § 1263.6(a)(5) if the applicant provides to the Bank an unqualified written certification duly adopted by the applicant's board of directors, or by an individual with authority to act on behalf of the applicant's board of directors, that:

(1) Enforcement actions. Neither the applicant nor any of its directors or senior officers is subject to, or operating under, any enforcement action instituted by its appropriate regulator;

(2) Criminal, civil or administrative proceedings. Neither the applicant nor any of its directors or senior officers has been the subject of any criminal, civil or administrative proceedings reflecting upon creditworthiness, business judgment, or moral turpitude since the most recent regulatory examination report; and

(3) Criminal, civil or administrative monetary liabilities, lawsuits or judgments. There are no known potential criminal, civil or administrative monetary liabilities, material pending lawsuits, or unsatisfied judgments against the applicant or any of its directors or senior officers since the most recent regulatory examination report, that are significant to the applicant's operations.

(b) CDFIs other than CDFI credit unions. A CDFI applicant, other than a CDFI credit union, shall be deemed to be in compliance with the character of management requirement of § 1263.6(a)(5), if the applicant provides an unqualified written certification duly adopted by the applicant's board of directors, or by an individual with authority to act on behalf of the applicant's board of directors, that:

(1) Criminal, civil or administrative proceedings. Neither the applicant nor any of its directors or senior officers has been the subject of any criminal, civil or administrative proceedings reflecting upon creditworthiness, business judgment, or moral turpitude in the past three years; and

(2) Criminal, civil or administrative monetary liabilities, lawsuits or judgments. There are no known potential criminal, civil or administrative monetary liabilities, material pending lawsuits, or unsatisfied judgments against the applicant or any of its directors or senior officers arising within the past three years that are significant to the applicant's operations.

§ 1263.14 Home financing policy requirement.

(a) Standard. An institution shall be deemed to be in compliance with the home financing policy requirements of section 4(a)(2)(C) of the Bank Act (12 U.S.C. 1424(a)(2)(C)) and § 1263.6(a)(6), if the institution has received a CRA rating of "Satisfactory" or better on its most recent CRA performance evaluation.

(b) Written justification required. An applicant that is not subject to the CRA shall file, as part of its application for membership, a written justification acceptable to the Bank of how and why the applicant's home financing policy is consistent with the Bank System's housing finance mission.

§ 1263.15 De novo insured depository institutions.

(a) Presumptive compliance. A de novo insured depository institution applicant shall be deemed to meet the duly organized, subject to inspection and regulation, financial condition, and character of management requirements of §§ 1263.7, 1263.8, 1263.12, and 1263.13, respectively.

(b) Makes long-term home mortgage loans requirement.—(1) Initial compliance. A de novo insured depository institution applicant shall be deemed to make long-term home mortgage loans, as required by section 4(a)(1)(C) of the Bank Act (12 U.S.C. 1424(a)(1)(C)) and § 1263.6(a)(3), if it has filed as part of its application for membership a written justification acceptable to the Bank of how its home financing credit policy and lending practices will include originating or purchasing long-term home mortgage loans.

(2) Subsequent compliance. A de novo insured depository institution member that has been deemed to comply with the makes long-term home mortgage loans requirement under paragraph (b)(1) of this section shall be deemed to remain in compliance on that basis until it submits to its appropriate regulator its next year-end regulatory financial report following the one year anniversary of the date it became a member. The Bank shall then determine compliance for that member as specified in § 1263.9, except that the Bank shall base that determination on the actual number of year-end regulatory financial reports the member has filed since the one year anniversary of the date it became a member until three such year-end reports are available.

(c) 10 percent requirement.—(1) Initial compliance. A de novo insured depository institution applicant that is subject to the 10 percent requirement of section 4(a)(2)(A) of the Bank Act (12 U.S.C. 1424(a)(2)(A)) and § 1263.6(b) shall be deemed to comply with that requirement if it commenced business operations less than one year before applying for Bank membership.

(2) Subsequent Compliance. A de novo insured depository institution member that was deemed to comply with the 10 percent requirement under paragraph (c)(1) of this section shall be deemed to remain in compliance on that basis until one year after commencing its initial business operations. Subsequently, the Bank shall determine compliance for that member as specified in § 1263.10, except that if the member has not yet filed three year-end regulatory financial reports, the Bank shall base that determination on the actual number of year-end regulatory financial reports the member has filed since commencing its initial business operations.

(d) Home financing policy requirement.—(1) Conditional approval. A de novo insured depository institution applicant that has not received its first CRA performance evaluation, shall be conditionally deemed to comply with the home financing policy requirement of section 4(a)(2)(C) of the Bank Act (12 U.S.C. 1424(a)(2)(C)) and § 1263.6(a)(6) if the applicant has filed, as part of its application for membership, a written justification acceptable to the Bank of how and why its home financing credit policy and lending practices will meet the credit needs of its community.

(2) Final approval. A de novo insured depository institution member that has been conditionally deemed to comply with the home financing policy requirement under paragraph (d)(1) of this section shall be deemed to remain in compliance on that basis until it receives its first CRA performance evaluation. If the member receives a CRA rating of “Satisfactory” or better on its first CRA performance evaluation and provides written evidence of that rating to the Bank, it shall be deemed to have complied with the home financing policy requirement and its membership approval shall cease to be conditional. If the member receives a rating of “Needs to Improve” or “Substantial Non-

Compliance" on its first CRA performance evaluation, and fails to rebut the presumption of non-compliance with the home financing policy requirement as provided under § 1263.18(f), it shall be deemed to have been out of compliance with the home financing policy requirement and the Bank's conditional approval of the membership application shall be deemed null and void.

(e) Other rules. A de novo insured depository institution member that was deemed to have complied with the eligibility requirements for membership by virtue of the alternative requirements of this section shall be subject to all regulations applicable to members generally, including those relating to stock purchase requirements and advances or collateral, notwithstanding the possibility that its membership may be conditional for some period of time. If a de novo insured depository institution's conditional membership is terminated due to a loss of eligibility for failure to comply with the requirements of this section, then the Bank shall liquidate any outstanding indebtedness and redeem or repurchase its capital stock in accordance with § 1263.29.

§ 1263.16 Recent merger or acquisition applicants.

(a) Financial condition requirement.—(1) Regulatory financial reports. For purposes of § 1263.12(a)(1), an applicant that, as a result of a recent merger or acquisition preceding the date it applies for membership, has not yet filed regulatory financial reports in the name of the combined institution for the last six calendar quarters and the last three calendar year-ends preceding the date it applies for membership, shall provide to the Bank any regulatory financial reports that the applicant has filed in the name of the combined institution with its appropriate regulator.

(2) Performance trend criteria. For purposes of § 1263.12(b)(3)(i)(A) to (C), an

applicant that, as a result of a recent merger or acquisition preceding the date it applies for membership, has not yet filed combined regulatory financial reports for the last six calendar quarters preceding such date, shall provide pro forma combined financial statements for those calendar quarters in which actual combined regulatory financial reports are unavailable.

(b) Home financing policy requirement. For purposes of § 1263.14, an applicant that, as a result of a recent merger or acquisition preceding the date it applies for membership, has not received its first CRA performance evaluation for the combined institution, shall file as part of its application, a written justification acceptable to the Bank of how and why the applicant's home financing credit policy and lending practices will meet the credit needs of its community.

(c) Makes long-term home mortgage loans requirement; 10 percent requirement. For purposes of determining initial compliance with §§ 1263.9 and 1263.10, a Bank may, in its discretion, permit an applicant that, as a result of a recent merger or acquisition preceding the date it applies for membership, has not yet filed a consolidated regulatory financial report as a combined entity, to provide the combined pro forma financial statement for the combined entity that the institutions filed with the regulator that approved the merger or acquisition. Subsequent compliance with these requirements shall be based on the post-merger regulatory financial reports filed by the combined entity.

§ 1263.17 Financial condition requirement for insurance company and certain CDFI applicants.

(a) Insurance companies.—(1) An insurance company applicant shall be deemed to meet the financial condition requirement of § 1263.6(a)(4) if the Bank determines:

(i) Based on the information contained in the applicant's most recent regulatory financial report filed with its appropriate regulator, that the applicant meets all of its minimum statutory and regulatory capital requirements and the capital standards established by the NAIC; and

(ii) Based on the applicant's most recent audited financial statements, that the applicant's financial condition is such that the Bank can safely make advances to it.

(2) In making this determination required under paragraph (a)(1)(ii) of this section, the Bank shall use audited financial statements of the insurance company applicant that have been prepared in accordance with generally accepted accounting principles, if they are available, or, in their absence, audited financial statements prepared in accordance with statutory accounting principles.

(b) <u>CDFIs other than CDFI credit unions</u>.—(1) <u>Review requirement</u>. In order for a Bank to determine whether a CDFI applicant, other than a CDFI credit union, has complied with the financial condition requirement of § 1263.6(a)(4), the applicant shall submit, as a part of its membership application, each of the following documents, and the Bank shall consider all such information prior to acting on the application for membership:

(i) <u>Financial statements</u>. An independent audit conducted within the prior year in accordance with generally accepted auditing standards by a certified public accounting firm, plus more recent quarterly statements, if available, and financial statements for the two years prior to the most recent audited financial statement. At a minimum, all such financial statements must include income and expense statements, statements of activities, statements of financial position, and statements of cash flows. The financial statement for the most recent year must include separate schedules or disclosures of the financial position of each of the applicant's affiliates, descriptions of their lines of business, detailed financial disclosures of the relationship between the applicant and its affiliates (such as indebtedness or subordinate debt obligations), disclosures of interlocking directorships with each affiliate, and identification of temporary and permanently restricted funds and the requirements of these restrictions;

(ii) CDFI Fund certification. The certification that the applicant has received from the CDFI Fund. If the certification is more than three years old, the applicant must also submit a written statement attesting that there have been no material events or occurrences since the date of certification that would adversely affect its strategic direction, mission, or business operations; and

(iii) Additional information. Any other relevant document or information a Bank requests concerning the applicant's financial condition that is not contained in the applicant's financial statements, as well as any other information that the applicant believes demonstrates that it satisfies the financial condition requirement of § 1263.6(a)(4), notwithstanding its failure to meet any of the financial condition standards of paragraph (b)(2) of this section.

(2) Standards. A CDFI applicant, other than a CDFI credit union, shall be deemed to be in compliance with the financial condition requirement of § 1263.6(a)(4) if it meets all of the following minimum financial standards—

(i) Net asset ratio. The applicant's ratio of net assets to total assets is at least 20 percent, with net and total assets including restricted assets, where net assets is calculated as the residual value of assets over liabilities and is based on information derived from the applicant's most recent financial statements;

(ii) Earnings. The applicant has shown positive net income, where net income is calculated as gross revenues less total expenses, is based on information derived from the applicant's most recent financial statements, and is measured as a rolling three-year average;

(iii) Loan loss reserves. The applicant's ratio of loan loss reserves to loans and leases 90 days or more delinquent (including loans sold with full recourse) is at least 30 percent, where loan loss reserves are a specified balance sheet account that reflects the amount reserved for loans expected to be uncollectible and are based on information derived from the applicant's most recent financial statements;

(iv) Liquidity. The applicant has an operating liquidity ratio of at least 1.0 for the four most recent quarters, and for one or both of the two preceding years, where the numerator of the ratio includes unrestricted cash and cash equivalents and the denominator of the ratio is the average quarterly operating expense.

§ 1263.18 Rebuttable presumptions applicable to applicants for Bank membership.

(a) Rebutting presumptive compliance. The presumption that an applicant meeting the requirements of §§ 1263.7 to 1263.17 is in compliance with the corresponding eligibility requirements of section 4(a) of the Bank Act (12 U.S.C. 1424(a)) and § 1263.6(a) and (b), may be rebutted, and the Bank may deny membership to an applicant, if the Bank obtains substantial evidence to overcome the presumption of compliance.

(b) Rebutting presumptive noncompliance. The presumption that an applicant not meeting a particular requirement of §§ 1263.8, 1263.12, 1263.13, 1263.14, or 1263.17, is not in compliance with the corresponding eligibility requirement of section 4(a) of the Bank Act (12 U.S.C. 1424(a)) and § 1263.6(a) may be rebutted. The applicant shall be deemed to be in compliance with an eligibility requirement, if it satisfies the applicable requirements in this section.

(c) Presumptive noncompliance by insurance company applicant with "subject to inspection and regulation" requirement of § 1263.8. If an insurance company applicant is not subject to inspection and regulation by an appropriate State regulator accredited by the NAIC, as required by § 1263.8, the applicant or the Bank shall prepare a written justification that provides substantial evidence acceptable to the Bank that the applicant is subject to inspection and regulation as required by § 1263.6(a)(2), notwithstanding the regulator's lack of NAIC accreditation.

(d) Presumptive noncompliance with financial condition requirements of §§ 1263.12 and 1263.17.—(1) Applicants subject to § 1263.12. For applicants subject to § 1263.12, in the case of an applicant's lack of a composite regulatory examination rating within the two-year period required by § 1263.12(b)(1), a variance from the rating required by § 1263.12(b)(3)(i), or a variance from a performance trend criterion required by § 1263.12(b)(3)(i), the applicant or the Bank shall prepare a written justification pertaining to such requirement that provides substantial evidence acceptable to the Bank that the applicant is in the financial condition required by § 1263.6(a)(4), notwithstanding the lack of rating or variance.

(2) Applicants subject to § 1263.17. For applicants subject to § 1263.17, in the case of an insurance company applicant's variance from a capital requirement or standard of § 1263.17(a) or, in the case of a CDFI applicant's variance from the standards of

§ 1263.17(b), the applicant or the Bank shall prepare a written justification pertaining to such requirement or standard that provides substantial evidence acceptable to the Bank that the applicant is in the financial condition required by § 1263.6(a)(4), notwithstanding the variance.

(e) Presumptive noncompliance with character of management requirement of § 1263.13.—(1) Enforcement actions. If an applicant or any of its directors or senior officers is subject to, or operating under, any enforcement action instituted by its appropriate regulator, the applicant shall provide or the Bank shall obtain:

(i) Regulator confirmation. Written or verbal confirmation from the applicant's appropriate regulator that the applicant or its directors or senior officers are in substantial compliance with all aspects of the enforcement action; or

(ii) Written analysis. A written analysis acceptable to the Bank indicating that the applicant or its directors or senior officers are in substantial compliance with all aspects of the enforcement action. The written analysis shall state each action the applicant or its directors or senior officers are required to take by the enforcement action, the actions actually taken by the applicant or its directors or senior officers, and whether the applicant regards this as substantial compliance with all aspects of the enforcement action.

(2) Criminal, civil or administrative proceedings. If an applicant or any of its directors or senior officers has been the subject of any criminal, civil or administrative proceedings reflecting upon creditworthiness, business judgment, or moral turpitude since the most recent regulatory examination report or, in the case of a CDFI applicant, during the past three years, the applicant shall provide or the Bank shall obtain—

(i) Regulator confirmation. Written or verbal confirmation from the applicant's appropriate regulator that the proceedings will not likely result in an enforcement action; or

(ii) Written analysis. A written analysis acceptable to the Bank indicating that the proceedings will not likely result in an enforcement action or, in the case of a CDFI applicant, that the proceedings will not likely have a significantly deleterious effect on the applicant's operations. The written analysis shall state the severity of the charges, and any mitigating action taken by the applicant or its directors or senior officers.

(3) Criminal, civil or administrative monetary liabilities, lawsuits or judgments. If there are any known potential criminal, civil or administrative monetary liabilities, material pending lawsuits, or unsatisfied judgments against the applicant or any of its directors or senior officers since the most recent regulatory examination report or, in the case of a CDFI applicant, occurring within the past three years, that are significant to the applicant's operations, the applicant shall provide or the Bank shall obtain—

(i) Regulator confirmation. Written or verbal confirmation from the applicant's appropriate regulator that the liabilities, lawsuits or judgments will not likely cause the applicant to fall below its applicable capital requirements set forth in §§ 1263.12(b)(2) and 1263.17(a); or

(ii) Written analysis. A written analysis acceptable to the Bank indicating that the liabilities, lawsuits or judgments will not likely cause the applicant to fall below its applicable capital requirements set forth in § 1263.12(b)(2) or § 1263.17(a), or the net asset ratio set forth in § 1263.17(b)(2)(i). The written analysis shall state the likelihood of the applicant or its directors or senior officers prevailing, and the financial consequences if the applicant or its directors or senior officers do not prevail.

(f) Presumptive noncompliance with home financing policy requirements of §§ 1263.14 and 1263.15(d). If an applicant received a “Substantial Non-Compliance” rating on its most recent CRA performance evaluation, or a “Needs to Improve” CRA rating on its most recent CRA performance evaluation and a CRA rating of “Needs to Improve” or better on any immediately preceding formal CRA performance evaluation, the applicant shall provide or the Bank shall obtain:

(1) Regulator confirmation. Written or verbal confirmation from the applicant’s appropriate regulator of the applicant’s recent satisfactory CRA performance, including any corrective action that substantially improved upon the deficiencies cited in the most recent CRA performance evaluation(s); or

(2) Written analysis. A written analysis acceptable to the Bank demonstrating that the CRA rating is unrelated to home financing, and providing substantial evidence of how and why the applicant’s home financing credit policy and lending practices meet the credit needs of its community.

§ 1263.19 Determination of appropriate Bank district for membership.

(a) Eligibility.—(1) An institution eligible to be a member of a Bank under the Bank Act and this part may be a member only of the Bank of the district in which the institution's principal place of business is located, except as provided in paragraph (a)(2) of this section. A member shall promptly notify its Bank in writing whenever it relocates its principal place of business to another state and the Bank shall inform FHFA in writing of any such relocation.

(2) An institution eligible to become a member of a Bank under the Bank Act and

this part may be a member of the Bank of a district adjoining the district in which the institution's principal place of business is located, if demanded by convenience and then only with the approval of FHFA.

(b) Principal place of business. Except as otherwise designated in accordance with this section, the principal place of business of an institution is the state in which the institution maintains its home office established as such in conformity with the laws under which the institution is organized and from which the institution conducts business operations.

(c) Designation of principal place of business.—(1) A member or an applicant for membership may request in writing to the Bank in the district where the institution maintains its home office that a state other than the state in which it maintains its home office be designated as its principal place of business. Within 90 calendar days of receipt of such written request, the board of directors of the Bank in the district where the institution maintains its home office shall designate a state other than the state where the institution maintains its home office as the institution's principal place of business, provided that, all of the following criteria are satisfied:

(i) At least 80 percent of the institution's accounting books, records, and ledgers are maintained, located or held in such designated state;

(ii) A majority of meetings of the institution's board of directors and constituent committees are conducted in such designated state; and

(iii) A majority of the institution's five highest paid officers have their place of employment located in such designated state.

(2) Written notice of a designation made pursuant to paragraph (c)(1) of this

section shall be sent to the Bank in the district containing the designated state, FHFA, and the institution.

(3) The notice of designation made pursuant to paragraph (c)(1) of this section shall include the state designated as the principal place of business and the Bank of which the subject institution is eligible to be a member.

(4) If the board of directors of the Bank in the district where the institution maintains its home office fails to make the designation requested by the member or applicant pursuant to paragraph (c)(1) of this section, then the member or applicant may request in writing that FHFA make the designation.

(d) Transfer of membership.—(1) In the case of a member that has designated its principal place of business in accordance with paragraph (c) to a State located in another Bank district, or in the case of a member that has relocated its principal place of business to a State in another Bank district, the transfer of membership from one Bank to another Bank shall not take effect until the Banks involved reach an agreement on a method of orderly transfer.

(2) In the event that the Banks involved fail to agree on a method of orderly transfer, FHFA shall determine the conditions under which the transfer shall take place.

(e) Effect of transfer. A transfer of membership pursuant to this section shall be effective for all purposes, but shall not affect voting rights in the year of the transfer and shall not be subject to the provisions on termination of membership set forth in section 6 of the Bank Act (12 U.S.C. 1426) or §§ 1263.26 and 1263.27, nor the restriction on reacquiring Bank membership set forth in § 1263.30.

(f) Insurance companies and CDFIs. For an insurance company or CDFI that cannot satisfy the requirements of paragraphs (b) or (c) of this section for designating its principal place of business, a Bank shall designate as the principal place of business the geographic location from which the institution actually conducts the predominant portion of its business activities. Such designations shall be based on the totality of the circumstances of the particular case and shall be evidenced by objective factors, such as the location from which the institution's senior officers direct, control and coordinate its activities, the locations of the offices from which the institution conducts its business, or the locations from which its other officers and employees carry out the business activities. In the case of an insurance company that maintains no physical offices of its own and has no employees of its own, or whose senior officers are situated at multiple locations, a Bank shall designate the state of domicile as the principal place of business for the insurance company. A Bank designating the principal place of business for a member under this provision shall document the bases for its determination in writing and shall include such documentation in the membership digest and application file for the institution.

Subpart D—Stock Requirements

§ 1263.20 Stock purchase.

(a) Minimum purchase requirement. An institution that has been approved for membership in a Bank as provided in this part shall become a member of that Bank upon purchasing the amount of stock required under the membership stock purchase provisions of that Bank's capital plan. If an institution fails to purchase the minimum amount of stock required for membership within 60 calendar days after the date on which it is approved for membership, the membership approval shall become void and that institution may not become a member of that Bank until after it has filed a new application and the Bank has approved that application pursuant to the requirements of this part.

(b) Issuance of stock. After approving an institution for membership, and in return for payment in full of the par value, a Bank shall issue to that institution the amount of capital stock required to be purchased under the Bank’s capital plan.

(c) Reports. Each Bank shall report to FHFA information regarding the minimum investment in Bank capital stock made by each new member referred to in paragraph (a) of this section, in accordance with the instructions provided in the Data Reporting Manual.

§ 1263.21 [Reserved].

§ 1263.22 Annual calculation of stock holdings.

A Bank shall calculate annually each member's required minimum holdings of Bank stock using calendar year-end financial data provided by the member to the Bank, pursuant to § 1263.31(d), and shall notify each member of the result. The notice shall clearly state that the Bank’s calculation of each member's minimum stock holdings is to be used to determine the number of votes that the member may cast in that year's election of directors and shall identify the state within the district in which the member will vote. A member that does not agree with the Bank’s calculation of the minimum stock purchase requirement or with the identification of its voting state may request FHFA to review the Bank’s determination. FHFA shall promptly determine the member's minimum required holdings and its proper voting state, which determination shall be final.

§ 1263.23 Excess stock.

(a) Sale of excess stock. Subject to the restriction in paragraph (b) of this section, a member may purchase excess stock as long as the purchase is approved by the member's Bank and is permitted by the laws under which the member operates.

(b) Restriction. Any Bank with excess stock greater than one percent of its total assets shall not declare or pay any dividends in the form of additional shares of Bank stock or otherwise issue any excess stock. A Bank shall not issue excess stock, as a dividend or otherwise, if after the issuance, the outstanding excess stock at the Bank would be greater than one percent of its total assets.

Subpart E—Withdrawal, Termination and Readmission

§ 1263.24 Consolidations involving members.

(a) Consolidation of members. Upon the consolidation of two or more institutions that are members of the same Bank into one institution operating under the charter of one of the consolidating institutions, the membership of the surviving institution shall continue and the membership of each disappearing institution shall terminate on the cancellation of its charter. Upon the consolidation of two or more institutions, at least two of which are members of different Banks, into one institution operating under the charter of one of the consolidating institutions, the membership of the surviving institution shall continue and the membership of each disappearing institution shall terminate upon cancellation of its charter, provided, however, that if more than 80 percent of the assets of the consolidated institution are derived from the assets of a disappearing institution, then the consolidated institution shall continue to be a member of the Bank of which that disappearing institution was a member prior to the consolidation, and the membership of the other institutions shall terminate upon the effective date of the consolidation.

(b) Consolidation into nonmember.—(1) In general. Upon the consolidation of a member into an institution that is not a member of a Bank, where the consolidated institution operates under the charter of the nonmember institution, the membership of the disappearing institution shall terminate upon the cancellation of its charter.

(2) Notification. If a member has consolidated into a nonmember that has its principal place of business in a state in the same Bank district as the former member, the consolidated institution shall have 60 calendar days after the cancellation of the charter of the former member within which to notify the Bank of the former member that the consolidated institution intends to apply for membership in such Bank. If the consolidated institution does not so notify the Bank by the end of the period, the Bank shall require the liquidation of any outstanding indebtedness owed by the former member, shall settle all outstanding business transactions with the former member, and shall redeem or repurchase the Bank stock owned by the former member in accordance with § 1263.29.

(3) Application. If such a consolidated institution has notified the appropriate Bank of its intent to apply for membership, the consolidated institution shall submit an application for membership within 60 calendar days of so notifying the Bank. If the consolidated institution does not submit an application for membership by the end of the period, the Bank shall require the liquidation of any outstanding indebtedness owed by the former member, shall settle all outstanding business transactions with the former member, and shall redeem or repurchase the Bank stock owned by the former member in

accordance with § 1263.29.

(4) Outstanding indebtedness. If a member has consolidated into a nonmember institution, the Bank need not require the former member or its successor to liquidate any outstanding indebtedness owed to the Bank or to redeem its Bank stock, as otherwise may be required under § 1263.29, during:

(i) The initial 60 calendar-day notification period;

(ii) The 60 calendar-day period following receipt of a notification that the consolidated institution intends to apply for membership; and

(iii) The period of time during which the Bank processes the application for membership.

(5) Approval of membership. If the application of such a consolidated institution is approved, the consolidated institution shall become a member of that Bank upon the purchase of the amount of Bank stock necessary, when combined with any Bank stock acquired from the disappearing member, to satisfy the minimum stock purchase requirements established by the Bank's capital plan.

(6) Disapproval of membership. If the Bank disapproves the application for membership of the consolidated institution, the Bank shall require the liquidation of any outstanding indebtedness owed by, and the settlement of all other outstanding business transactions with, the former member, and shall redeem or repurchase the Bank stock owned by the former member in accordance with § 1263.29.

(c) Dividends on acquired Bank stock. A consolidated institution shall be entitled to receive dividends on the Bank stock that it acquires as a result of a consolidation with a member in accordance with applicable FHFA regulations.

§ 1263.25 [Reserved].

§ 1263.26 Voluntary withdrawal from membership.

(a) In general.—(1) Any institution may withdraw from membership by providing to the Bank written notice of its intent to withdraw from membership. A member that has so notified its Bank shall be entitled to have continued access to the benefits of membership until the effective date of its withdrawal. The Bank need not commit to providing any further services, including advances, to a withdrawing member that would mature or otherwise terminate subsequent to the effective date of the withdrawal. A member may cancel its notice of withdrawal at any time prior to its effective date by providing a written cancellation notice to the Bank. A Bank may impose a fee on a member that cancels a notice of withdrawal, provided that the fee or the manner of its calculation is specified in the Bank's capital plan.

(2) A Bank shall notify FHFA within 10 calendar days of receipt of any notice of withdrawal or notice of cancellation of withdrawal from membership.

(b) Effective date of withdrawal. The membership of an institution that has submitted a notice of withdrawal shall terminate as of the date on which the last of the applicable stock redemption periods ends for the stock that the member is required to hold, as of the date that the notice of withdrawal is submitted, under the terms of a Bank's capital plan as a condition of membership, unless the institution has cancelled its notice of withdrawal prior to the effective date of the termination of its membership.

(c) Stock redemption periods. The receipt by a Bank of a notice of withdrawal shall commence the applicable 6-month and 5-year stock redemption periods, respectively, for all of the Class A and Class B stock held by that member that is not already subject to a pending request for redemption. In the case of an institution, the membership of which has been terminated as a result of a merger or other consolidation into a nonmember or into a member of another Bank, the applicable stock redemption periods for any stock that is not subject to a pending notice of redemption shall be deemed to commence on the date on which the charter of the former member is cancelled.

§ 1263.27 Involuntary termination of membership.

(a) Grounds. The board of directors of a Bank may terminate the membership of any institution that:

(1) Fails to comply with any requirement of the Bank Act, any regulation adopted by FHFA, or any requirement of the Bank's capital plan;

(2) Becomes insolvent or otherwise subject to the appointment of a conservator, receiver, or other legal custodian under federal or state law; or

(3) Would jeopardize the safety or soundness of the Bank if it were to remain a member.

(b) Stock redemption periods. The applicable 6-month and 5-year stock redemption periods, respectively, for all of the Class A and Class B stock owned by a member and not already subject to a pending request for redemption, shall commence on the date that the Bank terminates the institution's membership.

(c) Membership rights. An institution whose membership is terminated involuntarily under this section shall cease being a member as of the date on which the board of directors of the Bank acts to terminate the membership, and the institution shall have no right to obtain any of the benefits of membership after that date, but shall be entitled to receive any dividends declared on its stock until the stock is redeemed or repurchased by the Bank.

§ 1263.28 Loss of eligibility for continued membership; opportunity to cure.

(a) Loss of membership. A member that fails to remain in compliance with the "makes long-term home mortgage loans" requirement of § 1263.9 or, if applicable, the "10 percent" requirement of § 1263.10 as of the end of two consecutive calendar years shall become ineligible to remain a member of a Bank and shall have its membership terminated in accordance with this section.

(b) Initial noncompliance. If, when making its annual determinations of its members' ongoing compliance with §§ 1263.9 and 1263.10 that are required under § 1263.11, a Bank determines that a member has failed to comply with an applicable requirement as of the end of the most recent calendar year, the Bank shall:

(1) Provide the member with a written notice that:

(i) Informs the member that it has failed to satisfy an eligibility requirement for remaining a member of the Bank;

(ii) Identifies the eligibility requirements that the member has failed to meet and provides the data and calculations on which the Bank based its determination;

(iii) Describes the actions that the member must take in order to comply with the eligibility requirements and prevent the loss of its membership; and

(iv) Clearly states that the Bank will be required to terminate the institution's membership if it does not come into compliance with the particular eligibility requirement as of the end of the then-current calendar year; and

(2) Monitor the member's progress toward meeting the eligibility requirement by

calculating the relevant asset ratio on a quarterly basis for the remainder of that year, using the data sources specified in § 1263.11, and promptly notify the member of the Bank's assessment of the member's compliance with the eligibility requirements for each of those calendar quarters.

(c) Failure to cure noncompliance. If, when making its annual determinations of its members' ongoing compliance with §§ 1263.9 and 1263.10 that are required under § 1263.11, a Bank determines that a member that has been notified under paragraph (b) of this section that it has failed to comply with an applicable eligibility requirement as of the end of the preceding calendar year has also failed to comply with that eligibility requirement as of the end of a second consecutive year, the Bank shall terminate the membership of that institution for failure to comply with the statutory and regulatory eligibility requirements for membership, as provided under § 1263.27, and shall notify the member in writing of its action.

§ 1263.29 Disposition of claims.

(a) In general. If an institution withdraws from membership or its membership is otherwise terminated, the Bank shall determine an orderly manner for liquidating all outstanding indebtedness owed by that member to the Bank and for settling all other claims against the member. After all such obligations and claims have been extinguished or settled, the Bank shall return to the member all collateral pledged by the member to the Bank to secure its obligations to the Bank.

(b) Bank stock. If an institution that has withdrawn from membership or that otherwise has had its membership terminated remains indebted to the Bank or has outstanding any business transactions with the Bank after the effective date of its termination of membership, the Bank shall not redeem or repurchase any Bank stock that is required to support the indebtedness or the business transactions until after all such indebtedness and business transactions have been extinguished or settled.

§ 1263.30 Readmission to membership.

(a) In general. An institution that has withdrawn from membership or otherwise has had its membership terminated and which has divested all of its shares of Bank stock, may not be readmitted to membership in any Bank, or acquire any capital stock of any Bank, for a period of five years from the date on which its membership terminated and it divested all of its shares of Bank stock.

(b) Exceptions. An institution that transfers membership between two Banks without interruption shall not be deemed to have withdrawn from Bank membership or had its membership terminated.

Subpart F—Other Membership Provisions

§ 1263.31 Reports and examinations.

As a condition precedent to Bank membership, each member:

(a) Consents to such examinations as the Bank or FHFA may require for purposes of the Bank Act;

(b) Agrees that reports of examinations by local, state or federal agencies or institutions may be furnished by such authorities to the Bank or FHFA upon request;

(c) Agrees to give the Bank or the appropriate Federal banking agency, upon request, such information as the Bank or the appropriate Federal banking agency may need to compile and publish cost of funds indices and to publish other reports or statistical summaries pertaining to the activities of Bank members;

(d) Agrees to provide the Bank with calendar year-end financial data each year, for purposes of making the calculation described in § 1263.22; and

(e) Agrees to provide the Bank with copies of reports of condition and operations required to be filed with the member's appropriate Federal banking agency, if applicable, within 20 calendar days of filing, as well as copies of any annual report of condition and operations required to be filed.

§ 1263.32 Official membership insigne.

Members may display the approved insignia of membership on their documents, advertising and quarters, and likewise use the words "Member Federal Home Loan Bank System."

/s/

Melvin L. Watt,
Director, Federal Housing Finance Agency.

Dated: August 26, 2014